
Department of Corrections

Introduction

The Department of Corrections (DOC) manages the State's adult correctional facilities, youthful offender system, and the adult parole and community corrections system. In addition, the Department operates the prison canteens and the Division of Correctional Industries. The canteens provide various personal items for purchase by inmates, including hygiene items, snack foods, and phone services. Correctional Industries operates furniture manufacturing facilities, a leather products shop, Colorado State forms production and distribution facilities, dairy and agri-business facilities, the State's license plate manufacturing facility, and the state surplus property program.

The Department's Fiscal Year 2003 appropriation was approximately \$525.2 million with 6,123 full-time equivalent staff (FTE). Of this amount, \$455.1 million, or 87 percent, was general funds. Administrative offices for the Department are located in Canon City and Colorado Springs. During Fiscal Year 2003, DOC owned and operated 22 of the State's 26 correctional facilities. State-owned correctional facilities are located throughout Colorado and include sites in Buena Vista, Canon City, Denver, Pueblo, Limon, Ordway, Delta, Rifle, Golden, Sterling, Trinidad, and Fort Lyon. The remaining 4 facilities are privately owned and operated. DOC contracts with various counties, which in turn subcontract with private firms to provide correctional services at these facilities.

The following comment was prepared by the public accounting firm of BKD, LLP, which performed Fiscal Year 2003 audit work at the Department of Corrections.

Inmate Bank Accounts at Privately Operated Correctional Facilities

DOC and privately operated facilities maintain inmate bank accounts to allow inmates to receive approved deposits, make purchases from prison canteens, and pay for other items such as postage, copies, and money orders. While privately operated facilities maintain their own inmate bank accounts and records, DOC's Business Office, located in DOC's administrative offices in Canon City, is responsible for monitoring and overseeing the inmate bank account program for all facilities. As part of its management and oversight, DOC has designed and implemented internal

controls over inmate banking. DOC's policies require that facilities obtain and maintain complete and accurate documentation to support all inmate bank account activity, including deposits and withdrawals. At June 30, 2003, there were approximately 14,000 inmate bank accounts at DOC-operated facilities with a total balance of about \$1.8 million, and approximately 2,700 inmate accounts at privately operated facilities with a total balance of about \$305,000.

In order to determine the effectiveness of internal controls over the inmate banking program, BKD, LLP, performed certain agreed upon procedures specified by the Office of the State Auditor.

During the audit we documented the internal controls over inmate banking at DOC-operated and privately operated facilities. In order to determine the effectiveness of these controls, we selected a sample of 60 inmates from the DOC population and 60 inmates from the private facility population. For each inmate, we reviewed documentation for a two-month period during State Fiscal Year 2003. For our sample, we agreed deposit amounts to the check log for the day, agreed the total per the check log to the deposit slip, and agreed the deposit slip to the bank statement. We also performed the following procedures:

- We reviewed one canteen purchase per inmate per month and agreed the amount to the canteen purchase form signed by the inmate.
- For wages earned and posted to the inmate account, we agreed the amount to time sheets and other work records.
- For child support deductions, we agreed the amount to the child support order. We also agreed the amount to the summary paid to the Child Support Enforcement Division and observed the canceled warrant.
- For restitution, we recalculated the amount deducted and traced the amount to the detail of the payment to the court.
- For other elective withdrawals, we agreed the amount to the inmate request per DOC Administrative Regulation 200-02.
- For one month during the period, we obtained the inmate bank account reconciliation and reviewed the process for reconciling inmate bank accounts.
- We selected a sample of 25 inmate accounts, including inactive accounts and accounts of deceased inmates. From this sample, we determined whether the distribution of the account balance was in accordance with DOC policy.

While we noted no exceptions for inmate accounts maintained at DOC-operated facilities, we found three exceptions during our testing of inmate accounts maintained at privately operated facilities. Specifically, we found the following:

- **In one instance, the facility could not provide documentation for a miscellaneous deduction posted to the inmate's account.** All facilities must be able to provide evidence demonstrating that miscellaneous deductions are consistent with deductions allowed under DOC's policy.
- **In one instance, the facility could not provide a canteen slip that was signed by the inmate to support a deduction from the account.** The facility later provided a signed canteen slip that included a credit for a portion of the purchase. Inmates use canteen slips to place orders for merchandise from prison canteens. DOC's policy requires that inmates sign each canteen slip as evidence that the items listed on the slip were received. If orders have missing items, a new slip should be prepared and should be signed by the inmate prior to deducting the funds from the inmate's account.

DOC currently has a monitoring unit in place that is responsible for reviewing inmate bank account activity at privately operated facilities to ensure the proper withholding of mandatory restitution and child support payments. DOC should expand its monitoring function to include a review of the supporting documentation related to all inmate bank account activity. Failure to maintain adequate supporting documentation for all inmate banking activity decreases the effectiveness of the Department's internal control system and increases the risk that errors or irregularities will occur and not be detected. The Department should take additional steps to ensure that privately operated facilities are able to justify all activity that occurs in inmate bank accounts maintained at these facilities.

Recommendation No. 1:

The Department of Corrections should expand its monitoring process for privately operated facilities to ensure that complete and accurate documentation is maintained to support all activity in inmate bank accounts.

Department of Corrections Response:

Agree. The Department of Corrections agrees that additional monitoring will help insure that accurate documentation is being maintained by privately operated facilities. DOC will utilize its Internal Auditor to perform the additional testing recommended. The Private Prison Monitoring Unit will

support the Internal Auditor by requesting and gathering documents selected for the audit. DOC's Internal Auditor will schedule internal audits of at least two privately operated facilities each fiscal year. This will be implemented during Fiscal Year 2004.

Implementation date: June 30, 2004

Department of Health Care Policy and Financing

Introduction

The Department of Health Care Policy and Financing (HCPF) is the state agency responsible for developing financing plans and policy for publicly funded health care programs. The principal programs administered by HCPF include the Medicaid program, which provides health services to eligible needy persons, and the Children's Basic Health Plan (CBHP), which furnishes subsidized health insurance for children 18 years or younger in low-income families not eligible for Medicaid. The Medicaid grant is the largest federal program administered by the State and is funded approximately equally by federal funds and state general funds. CBHP, marketed as Child Health Plan Plus or CHP+, serves as the State's version of the federal Children's Health Insurance Program and is funded by approximately two-thirds federal funds and one-third state funds.

During Fiscal Year 2003 the Department expended in total about \$2.7 billion and had 198 full-time equivalent (FTE) staff. The public accounting firm of BKD, LLP, performed the audit work at HCPF as of and for the fiscal year ending June 30, 2003. During its audit, BKD, LLP, reviewed and tested HCPF's internal controls over financial reporting and federal programs as well as HCPF's compliance with certain state and federal laws and regulations.

The following was prepared by the public accounting firm of BKD, LLP, which performed the Fiscal Year 2003 audit work at the Department of Health Care Policy and Financing.

Accounts Receivable Reconciliations

Each state agency is responsible for establishing adequate controls and procedures to ensure that accounts receivable balances reported on the State's financial reporting system are accurate and complete. Specifically, this means that accounts receivable balances are valid and represent amounts due and collectible by the agency. The agency must also monitor these receivables to ensure that they are collected within a reasonable time frame and that year-end balances are adjusted if they are over- or understated.

During our audit we found that the Department had not reconciled the Medicaid Management Information System (MMIS) receivable account in COFRS to the MMIS subsidiary ledger since October 2002. While the balance in this account at June 30, 2003, on COFRS was \$5.4 million, the balance on MMIS at June 30, 2003, was about \$4.4 million, or \$1 million less. The MMIS receivable account is used to record amounts due to the Department for overpayments, payments of subsequently denied claims, and other payments that were paid through the MMIS payment system and thus are generally recouped through the MMIS system. This receivable account needs to be reconciled to the subsidiary ledger on a regular basis because some of the recoveries of funds from providers can occur only by methods outside of MMIS. For example, in some instances the Department must notify providers and require them to send in checks to reimburse the State for overpayments. It is necessary that HCPF reconcile this account on a regular basis in order that the account properly reflect the amounts receivable to the Department through MMIS and to enable the Department to monitor instances where other action must be taken.

Recommendation No. 2:

The Department of Health Care Policy and Financing should ensure that the accounts receivable balance for MMIS receivables is routinely reconciled to the subsidiary ledger balance in the MMIS system. Additionally, the Department should perform appropriate and timely follow-up on those cases where provider overpayments cannot be recouped through MMIS.

Department of Health Care Policy and Financing Response:

Agree. The Department has implemented the recommendation and is current with its reconciliation through the close of State Fiscal Year 2003-2004 Accounting Period 3 close. Additionally, the Department intends to fully utilize the services of the State's Central Collections Unit to collect amounts that are due the State that cannot be collected through the Medicaid Management Information System. Written policies and procedures for the management and collection of these provider overpayments will be completed and implemented by June 30, 2004.

Implementation date: June 30, 2004.

Department of Higher Education

Introduction

The Department of Higher Education was established under Section 24-1-114, C.R.S., and includes all public higher education institutions in the State. It also includes the Auraria Higher Education Center, the Colorado Commission on Higher Education, the Colorado Council on the Arts, the Colorado Student Loan Division, the Colorado Student Obligation Bond Authority, the State Historical Society, and the Division of Private Occupational Schools.

State public institutions of higher education are governed by eight different boards. The governing boards and the schools they oversee are:

- **Board of Regents of the University of Colorado**
 - University of Colorado at Boulder
 - University of Colorado at Colorado Springs
 - University of Colorado at Denver
 - Health Sciences Center
- **Board of Governors of the Colorado State University System**
 - Colorado State University
 - Colorado State University at Pueblo
- **Trustees of the State Colleges of Colorado**
 - Adams State College
 - Mesa State College
 - Western State College
 - Western Colorado Graduate Center
- **State Board for Community Colleges and Occupational Education (SBCCOE)**
 - 13 Community Colleges
- **Trustees of the University of Northern Colorado**
 - University of Northern Colorado
- **Trustees of the Colorado School of Mines**
 - Colorado School of Mines

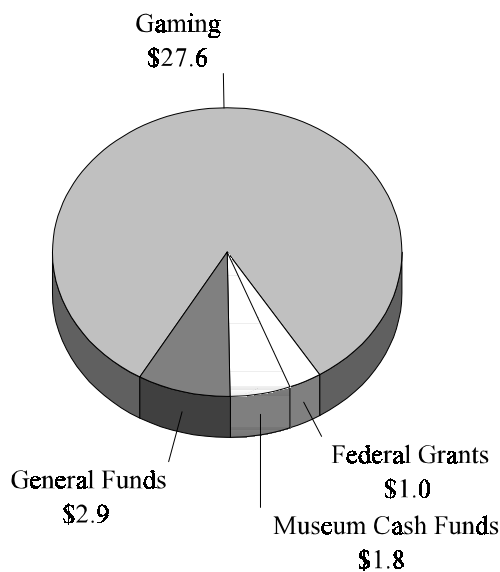
- **Board of Trustees for Fort Lewis College**
Fort Lewis College
- **Board of Trustees for Metro State College**
Metro State College

State Historical Society

The State Historical Society is statutorily designated as an educational institution in the State. It has exclusive control over the State's historical monuments and in this capacity has the duty to survey suitable sites and structures for historical designation by the State. The Society is charged with administration of a state register of historical properties. It also distributes gaming revenue to gaming cities through a grant program for historic preservation.

The State Historical Society was appropriated \$33.3 million and 106.4 full-time equivalent staff (FTE) for Fiscal Year 2003. Approximately 83 percent of the funding is from gaming revenue.

Colorado Historical Society
Fiscal Year 2003 Appropriations by Funding Source
(In Millions)



Source: Joint Budget Committee Fiscal Year 2004 Appropriations Report.

Interest Earned on Gaming Revenue

The Taxpayer's Bill of Rights (TABOR) was added as Article X, Section 20, of the Colorado Constitution in the November 1992 general election. In general, TABOR limits increases in the State's revenue to the annual inflation rate plus the percentage change in state population. TABOR exempts certain revenue from the revenue growth limitation, such as federal funds, damage awards, gifts to the State, property sales, the interest earned on these revenue streams, and the revenue of TABOR-exempt enterprises. Monies transferred from a state agency that is not a TABOR-exempt enterprise to another nonexempt state agency are also considered TABOR-exempt. This avoids double-counting the revenue, since it was already counted when earned by the original agency. However, any subsequent interest earned on the revenue transferred is subject to TABOR and should be included as TABOR revenue.

The State Historical Society is primarily funded through gaming revenue transferred from the Division of Gaming at the Department of Revenue. In Fiscal Year 2003 the State Historical Society received approximately \$27.6 million in gaming revenue. The revenue earned by the Division of Gaming was properly classified as nonexempt and included as TABOR revenue, and the State Historical Society properly recorded the revenue transferred as exempt. However, the State Historical Society erroneously reported the Fiscal Year 2001 through 2003 interest earnings on the gaming revenue as exempt from TABOR. For Fiscal Years 2001, 2002, and 2003, interest earned at the State Historical Society on gaming revenues totaled \$4,666, \$2,063,440, and \$1,919,339, respectively.

As a result, the Schedule of Computations Required Under Article X, Section 20, of the State Constitution (TABOR) and the Schedule of TABOR Revenue reports as of June 30, 2003, do not include an audit adjustment to Fiscal Year 2002 TABOR revenue of \$2,063,440 that would have increased the TABOR spending limit for Fiscal Year 2003 by \$2,205,818 and an adjustment to increase Fiscal Year 2003 TABOR revenue by \$1,919,339. Although the Fiscal Year 2002 adjustment affected the Fiscal Year 2003 spending limit, it will not impact future spending limits. Actual Fiscal Year 2003 revenue was less than the spending limit and is the basis for calculating the Fiscal Year 2004 spending limit.

Recommendation No. 3:

The State Historical Society should properly record revenue for TABOR reporting purposes.

The State Historical Society Response:

Agree. The Colorado Historical Society's Chief Financial Officer has made a journal entry indicating the appropriate revenue source code. This journal entry was made for the current fiscal year (Fiscal Year 2003-2004), and routine reporting of these revenues with the recommended revenue source code will be accomplished by the close of the Fiscal Year 2004 books.

Implementation date: June 30, 2004.

Colorado Student Obligation Bond Authority

The Colorado General Assembly established a student obligation bond program, a post secondary education expense program, and a college savings program, which are administered by the Colorado Student Obligation Bond Authority (d.b.a. CollegeInvest). The programs assist residents in meeting the expenses incurred in availing themselves of higher education opportunities.

Cash Flow Statements

Pursuant to Section 23-3.1-202, C.R.S., on May 26, 2000, CollegeInvest became a division of the Colorado Department of Higher Education. As part of the State, the CollegeInvest accounting system must be compatible with the State's accounting system, the Colorado Financial Reporting System (COFRS), to provide consistent reporting between the State and CollegeInvest and ensure that financial statements can be reconciled. CollegeInvest provides a specialized service within the state government and therefore has unique types of transactions. This creates difficulties in "mapping" CollegeInvest's accounts to COFRS accounts for the Statement of Cash Flows, which is one of the required financial statements under governmental accounting standards. In addition, CollegeInvest prepares its Statement of Cash Flows on the basis of individual transactions; however, the State Controller's Office prepares the Statement of Cash Flows at the statewide level on the basis of account balances. As a result, the State Controller's Office, which is responsible for compiling the statewide financial statements, has had difficulty reconciling the Statement of Cash Flows prepared by CollegeInvest with the statewide Statement of Cash Flows.

In preparing the Fiscal Year 2002 financial statements, the State Controller's Office

discussed the discrepancies with CollegeInvest and created procedures that CollegeInvest should follow to correct the differences and avoid similar problems in Fiscal Year 2003. Part of these procedures involved creating new accounts in the CollegeInvest system to more closely parallel the COFRS system. In preparing the Fiscal Year 2003 Statement of Cash Flows, CollegeInvest followed the procedures but certain new types of transactions not mapped to COFRS created problems with the reconciliation. For example, the following are differences between the 2003 CollegeInvest Statement of Cash Flows, before any changes, and the Statement of Cash Flows from the State Controller's Office:

<u>Classification on CollegeInvest Statement</u>	Over (under) State Controller's Statements
Cash received from fees for services	(13,547,000)
Cash received from grants and contracts	12,288,000
Cash payments for suppliers	(3,292,000)
Cash flows from investing activities:	
Proceeds from sale/maturity of investments	(10,475,000)

Once the differences were initially identified, CollegeInvest and the State Controller's Office made adjustments to the classification of amounts to bring the two statements into agreement.

Recommendation No. 4:

CollegeInvest should work with the State Controller's Office to resolve discrepancies between the Statement of Cash Flows prepared by CollegeInvest and by the State Controller's Office by:

- a. Determining what additional accounts need to be created on the CollegeInvest accounting system to facilitate the mapping of accounts to COFRS.
- b. Utilizing the new accounts in the development of the Statement of Cash Flows.
- c. Testing the procedures by preparing and reconciling the Statement of Cash Flows for an interim period agreed upon with the State Controller's Office.

- d. Upon resolution of discrepancies, documenting the procedures that should be used to prepare the Statement of Cash Flows, including information on how accounts map to COFRS.

CollegeInvest Response:

Agree. CollegeInvest agrees that it should continue to refine its mapping of internal general ledger accounts to the COFRS system. Each time CollegeInvest identifies a discrepancy the accounts are corrected as soon as possible. As a result of the Fiscal Year 2003 compilation of financial statements, additional discrepancies were noted due to changes in the both the State's and CollegeInvest's treatment of certain line items. These discrepancies were corrected as of the December 31, 2003 COFRS entries.

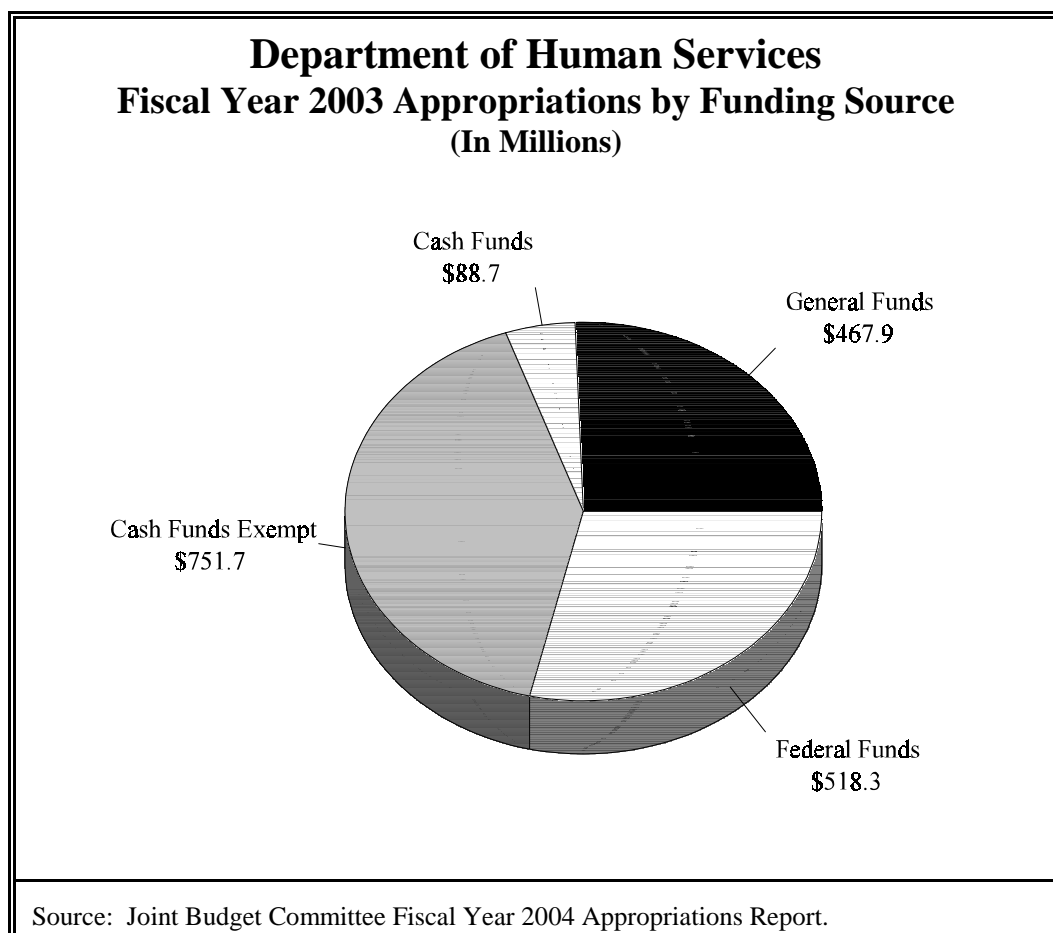
In order to reduce the time spent by CollegeInvest reconciling the Statement of Cash Flows at year end, CollegeInvest will prepare an internal Statement of Cash Flows periodically and compare the internal Statement of Cash Flows to the State Controller's Office automated Statement of Cash Flows. We have worked out a process with the State Controller's Office to make adjustments as necessary.

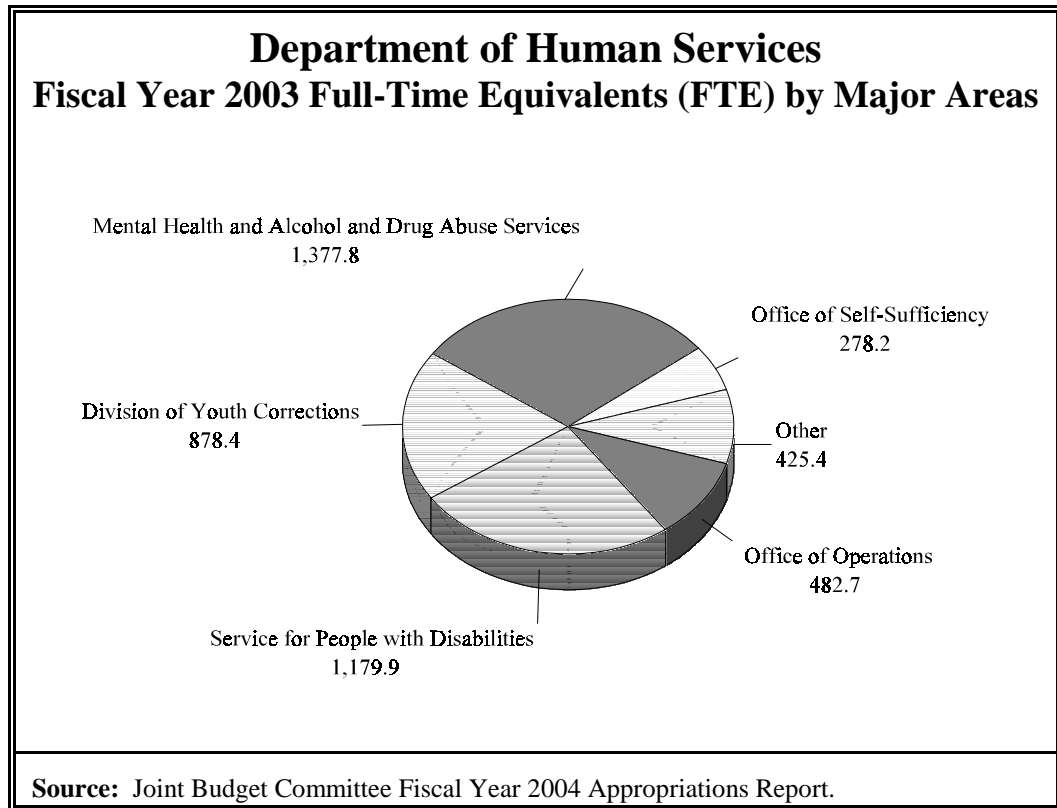
Implementation date: December 31, 2003.

Department of Human Services

Introduction

The Department of Human Services was created on July 1, 1994, to manage, administer, oversee, and deliver human services in the State. The Department supervises the administration of the State's public assistance and welfare programs throughout Colorado. Most of these programs are administered through local county departments of social services. In addition to these programs, the Department is responsible for operating a number of facilities that provide direct services, including mental health institutes, nursing homes, and youth corrections. In Fiscal Year 2003 the Department was appropriated approximately \$1.8 billion and 4,622.4 full-time equivalents, or FTE. The following charts show the appropriations by funding source and FTE by major areas within the Department, respectively, for Fiscal Year 2003:





We reviewed and tested the Department's internal accounting and administrative controls and evaluated compliance with state and federal rules and regulations. Generally, we found that the Department has adequate administrative and internal controls in place to oversee its operations and meet state and federal requirements. We identified seven areas where improvements could assist the Department in effectively managing its responsibilities — five related to financial controls and two related to federal awards. Please refer to the Department of Human Services chapter in the Federal Awards Findings section for recommendations related to federal awards.

Accounting Oversight and Controls

The Department of Human Services' Office of Operations includes the Divisions of Accounting, Facilities Management, Procurement, and County Allocations. Staff within the Division of Accounting are responsible for performing all accounting-related functions for the Department, including entering and approving all expenditure transactions on the State's accounting system (COFRS); preparing and submitting year-end reports, or "exhibits," to the State Controller's Office for preparation of the State's financial statements and related disclosures; tracking and requesting federal reimbursement for federal grant program expenditures; preparing

and submitting financial reports for federal programs; and ensuring the proper management and recording of the Department's capital assets. The Division was allocated 130 FTE and \$6.7 million for staff salaries and benefits for Fiscal Year 2003.

During our Fiscal Year 2003 audit, we continued to identify problems with the Division's controls over the accounting function. Overall, we have two primary concerns. First, we are concerned with the lack of adherence to statutory requirements that are directly related to the Division of Accounting's responsibilities. Specifically, during Fiscal Year 2003 we found that the Department circumvented legal spending limits related to federal reimbursements received for Title IV-E, discussed in the next section, and we have noted instances of circumvention of spending limits related to the use of unused year-end accounts payable accruals and indirect cost recoveries in recent years. Second, we are concerned with the Department's inability to remedy long-standing weaknesses in accounting controls, such as lack of adequate reconciliations and other procedures related to capital assets to ensure assets are safeguarded, inaccuracies in exhibits submitted for the preparation of the State's annual financial statements, and inadequate documentation to ensure the appropriateness and accuracy of payroll. These areas are all addressed separately in this report. While the Department has agreed to address these weaknesses in prior years, the problems remain and, in the cases of capital assets and exhibit preparation, have worsened. Further, throughout the audit we found that the Department was unable to provide requested documentation in a timely manner.

The problems we identified point to a lack of adequate staff knowledge and training in critical areas. The Department reports that budget cuts and staff turnover have exacerbated the Division's problems. For example, 25 accounting staff, or 19 percent of the Division's appropriated 130 FTE, retired or left the Division for other reasons during Fiscal Year 2003. Further, the Division lost 10 of its appropriated FTE due to budget cuts during the fiscal year. However, strong accounting controls become even more critical when budgets are cut and staff are required to perform new duties. The Department should address basic issues, such as establishing adequate written procedures to ensure accounting functions are performed properly, including appropriate levels of oversight and review of the Division's activities, and requiring that sufficient documentation be maintained to support transactions entered into COFRS in all instances.

The Department of Human Services is one of the State's largest department in terms of both annual expenditures and number of employees. Its operations are complex, involving many federal and state programs, and it maintains a wide variety of activities throughout the State. It is essential that the Department take immediate steps to strengthen overall accounting controls.

Recommendation No. 5:

The Department of Human Services should strengthen overall accounting controls by:

- a. Providing ongoing staff training in critical areas including accounting-related statutory requirements and legal obligations.
- b. Establishing written procedures for all basic accounting functions and requiring that adequate documentation be maintained for all entries.
- c. Implementing the appropriate level of supervisory review over all accounting activities.
- d. Reviewing all programs to ensure that the expenditures are properly recorded in compliance with spending authority.

Department of Human Services Response:

Agree. Due to the turnover in key staff positions and increased demands for information from the Joint Budget Committee and the Office of State Planning and Budgeting during year-end close and the audit, the necessary levels of training and supervision were not provided to accounting staff new to their positions. To remedy the situation, which continues with nine additional retirements to date in Fiscal Year 2004, the Division of Accounting is working with the State Controller's Office to provide additional training to all staff. An effort will be made to make staff aware of the Department's Accounting Manual which covers all basic accounting functions, and additional emphasis will be placed on state and federal laws and regulations. In the area of exhibit preparation and submission, the Deputy Controller will review all exhibits prior to their submission to the State Controller's Office and the auditors. Additional emphasis will be placed on close supervision for employees new to their positions and deadlines for submission of information to the auditors will be monitored and followed-up on a weekly basis. In addition to the regular review of expenditures for propriety during the fiscal year, increased emphasis will be placed on review of entries made to programs at year-end.

Implementation date: October 2004.

Title IV-E Statutory Compliance

Title IV-E of the federal Social Security Act provides assistance to states for child welfare services including foster care services and adoption assistance for children with special needs. During Fiscal Year 2003 the Department of Human Services expended approximately \$164.4 million in state and federal funds for these two programs.

Title IV-E programs are overseen by the Department's Division of Child Welfare Services within the Office of Child and Family Services and administered locally by the county departments of social services. The Department is reimbursed by the federal government for allowable costs incurred for providing child welfare services.

Senate Bill 91-80 enacted during the 1991 Session defined certain parameters to be used by the State in providing funds to the counties for child welfare services. Under Section 26-1-111(2)(II), C.R.S., the General Assembly is required to annually determine the base amount needed to fully fund the State's Title IV-E programs. This determination must reflect rate changes, workload, federal financial participation, and any other factors necessary to maintain a level of services comparable to services provided the prior year. The General Assembly's determination of the base amount is enacted as part of the State's Long Bill. Based on the spending level established in the Long Bill, the Department enters the authorized spending levels in the State's accounting system for all Department funding, including child welfare. All departmental expenditures are charged against the specific appropriation codes.

Section 26-1-111(2)(II), C.R.S., requires the Department to pay to the counties any amount of federal reimbursement it receives in excess of the annual base amount established by the General Assembly in proportion to each county's Title IV-E eligible caseload. The counties, in turn, are to expend the excess funds for child welfare services directed toward early intervention, placement prevention, and family preservation. At the end of each fiscal year, the Department determines the amount of excess federal funds received for Title IV-E programs, if any, and sets the amount aside for payment to the county departments of social services in the subsequent year.

We found that the Department has not adhered to the statutory requirement that federal funds received in excess of the annual base amount be paid to the counties. Rather, since Fiscal Year 2000, the Department has used a portion of the excess Title IV-E funds in the subsequent fiscal year. Therefore, not all required monies have gone into direct services for child welfare purposes as directed in law. Amounts due to and amounts paid to the counties, amounts withheld but not used by the

Department, and amounts withheld and used by the Department for Fiscal Years 1999 through 2003 are shown in the following table.

Department of Human Services Excess Title IV-E Funds Due to County Departments of Social Services Fiscal Years 1999 Through 2003				
Fiscal Year	Amount Due to Counties^a	Amount Paid to Counties^b	Amount Withheld but Not Used by Department^c	Amount Used by the Department^d
1999	\$10,473,106	\$10,173,106	\$300,000	\$0
2000	\$5,779,341	\$5,179,341	\$106,942	\$493,058
2001	\$10,741,002	\$10,091,002	\$502,846	\$147,154
2002	\$13,397,309	\$11,975,353	\$599,077	\$822,879
2003	\$16,198,332	\$0 ^e	\$0 ^e	\$0 ^e
Fiscal Years 2000-2003 Total Amount Used for Department-Level Expenditures				\$1,463,091
Source: Department of Human Services data. ^a Includes current-year excess federal Title IV-E reimbursements plus any balance of prior year excess amounts still due to counties. ^b The Department's policy is to pay the counties in the subsequent fiscal year. For example, Fiscal Year 1999 "Amount Paid to Counties" of almost \$10.2 million was paid to the counties in Fiscal Year 2000. ^c Represents year-end balance held by the Department but not used by the Department. ^d Expenditures were made for Departmental purposes in the subsequent fiscal year. For example, the \$493,058 held by the Department from Fiscal Year 2000 Title IV-E excess federal funds was expended by the Department in Fiscal Year 2001. ^e In accordance with Department policy, Department staff report that counties will be paid Fiscal Year 2003 Title IV-E excess funds in the subsequent year (Fiscal Year 2004).				

In some cases, the Department used a portion of the amount identified as Title IV-E excess funds for expenditures related to the Title IV-E program; however, in other cases, the Department used a portion of the excess for non-Title IV-E program expenditures. Specifically, we noted that the Department used \$798,000 of the \$13.4 million identified as Title IV-E excess funds for Fiscal Year 2002 for non-Title IV-E expenditures incurred in Fiscal Year 2003. We reviewed three transactions recorded at the end of Fiscal Year 2003 and found that excess Title IV-E funds had been used to cover general fund overexpenditures totaling \$743,159. These overexpenditures were for costs related to Office of Self-Sufficiency programs, which include federal Food Stamps and the Low-Income Energy Assistance Program; the Client-Oriented Information Network, which is not used to track Title IV-E program activity; and Office of Operations administration and personal services expenditures. The Office of Operations includes the Division of Accounting, which initiated and approved

these transactions. By using excess Title IV-E federal reimbursements to cover these expenditures, the Department, in effect, increased its appropriations in these areas by \$743,159. Further, we reviewed an additional 19 Fiscal Year 2003 transactions totaling \$54,936 and noted that Title IV-E excess funds were used to cover other non-Title IV-E expenditures such as costs related to Office of Operations telephone charges, including long distance; furniture installation services performed at the Department of Health Care Policy and Financing; and furniture moving and electrical services performed at the Fort Logan campus. We also found that the Department used an additional \$640,000 of the identified excess from Fiscal Years 2000 and 2001 for Department expenditures incurred in Fiscal Years 2001 and 2002.

As of the end of our audit, the Department had not paid out the \$16.2 million due to the counties for Fiscal Year 2003; the Department's policy is to pay the funds in the subsequent year. However, the Department reported that it had set aside \$600,000 of the \$16.2 million for anticipated additional Title IV-E expenditures, rather than for payment to the counties. In total, the Department has spent about \$1.46 million of excess Title IV-E funds for Department-level expenditures from Title IV-E excess federal funds received during Fiscal Years 2000 through 2002, excluding the \$600,000 that has been set aside but not yet expended from Fiscal Year 2003 excess Title IV-E funds.

We concur that it is appropriate for the Department to pay the excess Title IV-E funds to the counties in the subsequent year in order to ensure that amounts identified as total Title IV-E expenditures for the fiscal year and, in turn, excess funds, are accurate. However, the Department's use of excess Title IV-E funds violates statutory provisions that specifically require the Department to return all excess Title IV-E funding to the counties. Statutes do not allow the Department to use a portion of excess funds for either Title IV-E or non-Title IV-E purposes. For instances in which the Department determines payment of expenditures from Title IV-E funding may be appropriate but would exceed the base funding amount originally established by the General Assembly for the program, the Department should request a supplemental appropriation from the Joint Budget Committee.

In cases where excess Title IV-E funds were used to cover non-Title IV-E expenditures, we have two concerns. First, by charging expenditures to an unrelated appropriation, the Department circumvented controls established by the appropriations process over agencies' spending authority. Second, by using an unrelated funding source to cover overexpenditures, the Department did not follow procedures established under state statutes that require agencies to report overexpenditures and obtain approval from the State Controller, Office of State Planning and Budgeting, and the Governor for such expenditures. Subject to this approval, an agency's appropriation in the subsequent year is restricted for the

amount of the overexpenditure. Because the Department did not appropriately report the overexpenditures, no restrictions were imposed on the Department.

We identified problems with the Department's adherence to legally established spending limits in our Fiscal Year 2001 and 1997 audits. In Fiscal Year 1997 the Department charged certain payments that would have resulted in an overexpenditure directly to indirect cost recoveries instead of against an expenditure or appropriation code. In Fiscal Year 2001 the Department charged personal services payments against an unrelated and unused accounts payable; in this case, the Department stated that if it had recorded the transaction correctly, it could have made adjustments to other year-end accruals and avoided an overexpenditure. Nonetheless, in both instances the Department was able in practice to increase its appropriations without legal authorization. In both cases, the Department agreed with recommendations to follow state statutes and record transactions appropriately.

Our findings in Fiscal Year 2003 indicate that the Department has not taken sufficient action to ensure that funds are spent in accordance with appropriations created by law and in accordance with statutory requirements. The Department must establish procedures and controls that ensure funds are handled appropriately and transactions recorded correctly. This includes requiring staff to have familiarity with the legal spending requirements for departmental programs; recording expenditures within the proper appropriation codes; reviewing entries made to the State's financial system for unusual activity, especially at the end of the fiscal year; and reverting all statutorily required excess Title IV-E funds to the counties. Finally, in future years, the Department should request supplemental spending authority from the Joint Budget Committee for Title IV-E related expenditures exceeding the base appropriation originally established by the General Assembly and follow statutory procedures in the case of overexpenditures.

Recommendation No. 6:

The Department of Human Services should adhere to state statutes regarding expenditure of funds by:

- a. Ensuring staff are sufficiently familiar with statutory requirements related to departmental programs.
- b. Charging expenditures to the proper appropriation code and reviewing entries to the State's accounting system for unusual activity.

- c. Reimbursing excess Title IV-E funds due to the counties but used by the Department for non-Title IV-E purposes in prior fiscal years.
- d. Requesting supplemental appropriations from the Joint Budget Committee for Title IV-E related expenditures exceeding the original base appropriation in future years.
- e. Notifying the State Controller when an overexpenditure occurs.

Department of Human Services Response:

Agree.

- a. The Department will begin formal training to familiarize personnel with the statutory requirements of the various programs that we account for. Training will begin in March 2004.
- b. We will implement and strengthen the supervisory review of all entries made to COFRS and continue to train individuals on COFRS diagnostics and usage of the COFRS database for analysis.
- c. The Department will pursue a supplemental discussion with the Office of State Planning and Budgeting.
- d. If necessary, the Department will request supplemental appropriations from the Joint Budget Committee for Title IV-E related expenditures exceeding the original base appropriation.
- e. The Department will comply with the requirement to report overexpenditures to the State Controller when they occur.

Implementation date: March 2004.

Capital Assets

Each department is responsible for ensuring that all capital assets purchased or constructed by the State are properly accounted for when acquired and disposed of, accurately inventoried, and safeguarded throughout their lives. For Fiscal Year 2003 the Department managed over \$213 million in capital assets net of accumulated depreciation. As part of our audit, we reviewed the Department's controls in several

areas including reconciliations of retainages on construction contracts, transfers of completed capital construction projects, year-end physical inventories, capital asset reconciliations, capital lease transactions, and reimbursement of construction expenditures. We noted problems in each of these areas.

Retainage on Capital Construction Projects: Agencies are required by statute to retain a percentage of payments made on capital construction projects until the project is completed to the State's satisfaction. Retainages are recorded on the State's financial system, COFRS, for each project under construction. According to the Fiscal Procedures Manual published by the State Controller's Office, the Department is required to perform a year-end reconciliation of each project's retainage to ensure the amount recorded in COFRS is accurate and to make any necessary adjustments. However, we found that Department staff did not conduct reconciliations at the end of Fiscal Year 2003 for the Department's eight capital projects in place during the fiscal year. Specifically, for one project, which represented \$2.97 million, or 91 percent, of the \$3.27 million retainage balance at June 30, 2003, staff did not perform a reconciliation until October 2003, three months after the end of the fiscal year.

Transfer of Completed Capital Construction Projects: When a capital construction project with costs exceeding \$5,000 is determined to be complete at fiscal year-end, the Department is required under the Fiscal Procedures Manual to transfer the final cost of the completed project from construction in progress to the appropriate asset account, such as buildings or land improvements. We found that the Department did not transfer a total of approximately \$2.1 million in construction costs for five projects completed during Fiscal Year 2003 to the related asset account at year-end. Additionally, we identified that during Fiscal Year 2003 the Department did not transfer approximately \$1 million in construction expenditures from construction in progress to a related asset account for projects that were completed but not transferred at the end of Fiscal Year 2002. Therefore, at June 30, 2003, construction in progress was overstated by approximately \$3.1 million and various capital assets were understated by the same amount.

Physical Inventories: According to Fiscal Procedures, furniture and equipment assets with a useful life of more than one year and a value of \$5,000 or greater should be inventoried annually at June 30. Agencies have the option of performing the physical inventory prior to June 30 but after March 31. However, the agency must inform the Office of the State Auditor if it elects to perform the physical inventory prior to year-end and adjust for additions and deletions from the date the inventory was taken to June 30. We found that the Department conducted its physical inventory in May 2003, but did not inform our office of the early inventory count. In addition, approximately \$57,000 in differences identified between the physical

inventory listing and COFRS were not investigated and adjustments were not made to COFRS at year-end.

Capital Asset Reconciliations: Department procedures require staff to perform quarterly reconciliations of capital asset expenditures to amounts recorded as additions and deletions to capital assets on COFRS and to submit the reconciliations to the Department's central accounting office. However, during Fiscal Year 2003 we found that although all 16 agencies within the Department submitted year-end reconciliations, the five state nursing homes administered by the Department did not submit quarterly reconciliations. Further, two of the five nursing homes (State Veterans Center at Homelake and Fitzsimons State Veterans Nursing Home) submitted their year-end reconciliations in mid-October, nearly four months after the end of the fiscal year.

Additionally, we found the reconciliations were not adequate to ensure that assets had been properly accounted for throughout the year and that capital asset balances at June 30, 2003, were accurate and complete.

- C For 18 balances contained on 11 of 16 (69 percent) reconciliations reviewed, amounts did not agree to COFRS year-end closing balances. In 11 cases, staff had reconciled balances to earlier months in the fiscal year. For example, the Colorado Mental Health Institute at Pueblo's balances contained on its year-end reconciliation agreed to the May 31, 2003, balance on COFRS, and the Pueblo Regional Center's balances on its year-end reconciliation agreed to the December 31, 2002, COFRS balance, rather than to the June 30, 2003, balance.
- C For 3 of 16 (19 percent) reconciliations reviewed, the reconciliation did not include all capital assets and related accounts on the reconciliation. For example, the State Veterans Center at Homelake did not include any capital asset accumulated depreciation accounts on its year-end reconciliation. This is problematic because the Department's central accounting office identified a discrepancy of approximately \$400,000 in the Home's accumulated depreciation account at year-end that was unresolved. Although Department accounting staff followed up with the Home regarding the difference, the discrepancy was still unresolved at the end of our audit work in November 2003.

The Department is responsible for ensuring reconciliations are sufficient to ensure capital assets and related accounts are correct. Currently the Department's internal capital asset reconciliation procedures do not require that reconciliations prepared by agency staff include the entire fiscal year or state which accounts are to be reconciled. The Department should revise its procedures to address these two areas.

Capital Leases: For the past several fiscal years, the Department has entered into capital leases for microcomputers and telephones. During Fiscal Year 2003 the Department performed a complete reconciliation of all outstanding leases. As a result of the reconciliation, Department staff identified errors in methodologies used by staff to record and calculate prior year leases and related depreciation expense. Specifically, errors included the use of incorrect present value tables and the failure to record prepaid amounts. Upon identification of the errors, Department staff made correcting entries on COFRS for many prior and current year leases. We reviewed a sample of seven of the correcting transactions related to the capital lease reconciliation process. We found that the Department could not provide adequate supporting documentation for five of the seven (71 percent) transactions tested. As a result, we were unable to determine if the net effect of the transactions to increase capital leases by nearly \$3.1 million and to decrease accumulated depreciation on capital leases by \$2.8 million was appropriate.

Request for Construction Expenditures: Construction of the Fitzsimons State Veterans Nursing Home began in Fiscal Year 1999 and continued during Fiscal Year 2003. The Home began admitting patients in October 2002. We found the Department did not submit reimbursement requests for the federal share of construction expenditures from the federal Veterans Administration at any time during Fiscal Year 2003. We reviewed the federal receivable account and noted that about \$1.5 million was due to the State at the end of August 2002. The final balance due at the end of Fiscal Year 2003 was approximately \$2.7 million. The lack of timely reimbursement requests for these expenditures means the State lost the opportunity to use these funds because general funds were used to cover the expenditures.

We have identified control weaknesses over capital assets at the Department since Fiscal Year 1998. The size of the Department and the disbursement of its activities throughout the State create a greater risk that assets could be lost or misappropriated. It is imperative that the Department ensure that all areas related to capital assets, including construction, are reviewed throughout the year and adjustments are made at year-end to accurately reflect the status of the Department's assets.

Recommendation No. 7:

The Department of Human Services should improve controls over capital assets by:

- a. Ensuring that retainage payable accounts are reconciled at fiscal year-end and that required adjusting entries are made to year-end balances.

- b. Transferring costs for completed capital construction projects to appropriate asset accounts prior to year-end close.
- c. Notifying the Office of the State Auditor in advance of physical inventories conducted after March 31 but prior to June 30, investigating all discrepancies, and making adjustments on COFRS as appropriate.
- d. Revising existing capital asset reconciliation procedures to state that reconciliations be prepared through fiscal year-end and list all the balances to be reconciled, and requiring all Department agencies to perform capital asset reconciliations timely and accurately and in accordance with Department policies.
- e. Maintaining adequate supporting documentation for capital lease entries recorded on COFRS.
- f. Requesting federal reimbursement of outstanding construction expenditures at the Fitzsimons State Veterans Nursing Home project on a timely basis.

Department of Human Services Response:

- a. Agree. Although retainage payable accounts have been regularly reconciled quarterly by accounting staff, they have not been regularly reconciled to what the program believes the balance should be. A new procedure will be implemented to ensure that each retainage payable balance is reconciled with program at year-end, at a minimum, and preferably on a quarterly basis.

Implementation date: July 2004.

- b. Agree. With the change in staff in capital assets during Fiscal Year 2003 the emphasis was on correcting the capital lease expenditure accounts and balance sheet amounts at year-end. As a result, no time remained to research amounts in construction in process that had been there for several years. Subsequently, the research was begun and is nearly finished.

Implementation date: July 2004.

- c. Agree. Because neither the new or previous capital asset supervisor had been in the position a full year, neither was aware of the requirement to notify the Office of the State Auditor of physical asset inventories

conducted prior to June 30. The new capital asset supervisor will be fully informed of this requirement when he or she is hired and trained. The Deputy Controller will ensure that proper notification is made for Fiscal Year 2004 and that the results of the inventories are reconciled to the financial records and necessary adjustments made.

Implementation date: July 2004.

- d. Agree. All capital asset procedures are currently being reviewed and revised. An emphasis will be made in the procedures and during training sessions prior to year-end close on timely preparation of accurate capital asset reconciliations.

Implementation date: July 2004.

- e. Agree. Fiscal Year 2003 was the year following implementation of the new reporting standards for fixed assets. After implementation in Fiscal Year 2002, the State Controller's Office noted that incorrect expenditure accounts had been used to record microcomputer capital lease payments. Use of the incorrect accounts had continued into Fiscal Year 2003. The new capital asset supervisor placed a high priority on correcting the miscodings, researching where and how the microcomputer leases should be recorded, and developing a database to track microcomputer lease payments and balances. Due to the short time span available for making corrections, the supervisor prepared the entries necessary to get the liabilities correct at June 30. In some cases, the calculations made to arrive at the needed entry were not documented for inclusion with the entries. Currently, proper documentation is being prepared and attached to all entries for capital leases.

Implementation date: April 2004.

- f. Agree. Requests for federal reimbursement of outstanding construction expenditures at the Fitzsimons State Veterans Nursing Home project were brought up-to-date in November 2003. Subsequent requests have been made in a timely manner. The final request should be made by March 31, 2004.

Implementation date: March 31, 2004.

Exhibit Preparation

At the end of the fiscal year, the State Controller's Office requires that each department submit financial and financial-related information that aids the preparation of the State's financial statements and footnote disclosures. The State Controller's Office requires that all departments submit this information on uniform reports, or "exhibits." During Fiscal Year 2003 we reviewed exhibits prepared and submitted to the State Controller by the Department of Human Services' 13 agencies and found the following errors.

The Department submitted 146 exhibits to the State Controller's Office for Fiscal Year 2003. Forty-nine percent of the exhibits (71 of 146) required at least one revision. Further, 32 of the 71 revised exhibits, or nearly half, were revised due to errors or omissions we identified through our audit. For example, we requested that the Department prepare revised exhibits due to the following problems:

- **Schedule of Federal Assistance (Exhibit K):** This exhibit shows the federal receipts and expenditures for the Department's administration of grant programs, and it is the basis for the State's Schedule of Expenditures of Federal Funds (SEFA) submitted to the federal government each year. We found that \$14 million in expenditures for the Low-Income Energy Assistance Program were misclassified on the Department's Exhibit K for its largest agency.
- **Schedule of Capital Leases (Exhibit F1):** The Department is required to report all capital leases on this exhibit. We found the Department did not include the total amount of capital assets under lease, as required by the Fiscal Procedures Manual, for the 15 exhibits submitted. The dollar amount of the exclusions ranged from about \$3,000 to \$9.4 million, with total exclusions of approximately \$10.2 million.
- **Cash on Hand or Deposited With Financial Institutions (Exhibit M):** This exhibit is used to report an agency's cash that is held by a financial institution other than the State Treasurer. In order to meet financial statement disclosures, the State must indicate how safe public funds are (e.g., whether the funds are insured by the Federal Deposit Insurance Corporation, or secured by other means) by classifying these funds into risk categories. We noted three instances in which the Department did not classify funds in the proper risk category. The total of these classification errors was about \$9.4 million.

- **Schedule of Changes in Capital Assets for Governmental Funds and Internal Service Funds (Exhibit W1):** This exhibit presents the additions and deletions of capital assets for the fiscal year. We identified three exhibits containing amounts that did not agree to the State's accounting system, COFRS. These errors ranged from approximately \$5,400 to \$1.8 million and totaled about \$1.9 million.

In Fiscal Year 2002 we also identified problems with the Department's preparation and submission of year-end exhibits. Specifically, we found through our testwork that 16 percent of the exhibits contained errors and required revisions. The increase in this error rate to 45 percent for Fiscal Year 2003 indicates the Department is continuing to have difficulties ensuring the information on the exhibits is complete and accurate. The Department should improve controls over the preparation of its exhibits in order to ensure the State's financial statements and related footnotes are accurate and that time required to correct and revise exhibits is minimized.

The Fiscal Procedures Manual provides general descriptions for the preparation of exhibits and the State Controller's Office conducts annual training related to changes in the manual. However, the Department should institute an annual internal training program to be conducted prior to year-end that would address Department-specific issues and provide specific guidance to those Department staff preparing exhibits. Further, the Department should institute a secondary review process for all exhibits prepared to ensure the accuracy prior to submission to the State Controller's Office.

Recommendation No. 8:

The Department of Human Services should improve controls over the preparation of exhibits to increase the accuracy of information submitted to the State Controller's Office and to lessen staff time required to correct and revise exhibits by:

- a. Developing and conducting training prior to year-end for staff preparing exhibits.
- b. Instituting a secondary review process over all exhibits to ensure their accuracy prior to submission.

Department of Human Services Response:

Agree. Due to medical leave followed by retirement in April of the staff person who had responsibility for exhibits, there was little training time for

the person assigned to this position. As a result, exhibits were not begun far enough in advance of the deadline to allow for a proper review prior to submission. It should also be noted that, due to a misunderstanding, several of the exhibits were given to the audit team prior to their submission to the State Controller's Office. Many of the errors noted by the auditors were corrected prior to submission to the State Controller's Office. Several other exhibits submitted to the State Controller's Office had to be revised and resubmitted. For Fiscal Year 2004, training on the preparation of exhibits will be presented by the State Controller's Office and preparation of the exhibits will begin as soon as is reasonable after year-end. The Deputy Controller will perform a detailed review of all exhibits prior to their submission to either the auditors or the State Controller's Office.

Implementation date: September 2004.

Payroll Controls

During Fiscal Year 2003 the Department of Human Services employed over 4,600 full-time equivalents (FTE) and expended over \$219.3 million in total payroll costs, representing about 14 percent of the total departmental expenditures. We performed testwork to determine the adequacy of the Department's controls over payroll and noted an area in which the controls need to be improved. Specifically, 21 of the 41 employee time sheets reviewed (51 percent) were not dated by either the employee or the supervisor. We also noted that 9 of the 41 time sheets (22 percent) containing both signatures and dates were dated 20 days or more after the end of the previous pay period.

The Department currently does not require time sheets to be signed within a specified period of time after the end of the pay period or that employees and supervisors provide the date when signing time-sheets. Thus, payroll errors and necessary adjustments may not be identified in a timely manner. Establishing a time-frame for signature, or certification, and requiring that certifications be dated would provide more assurance that payroll is accurate and that necessary adjustments are identified and made timely.

Recommendation No. 9:

The Department of Human Services should improve payroll controls by:

- a. Monitoring time sheets to ensure they are dated by both the employee and the supervisor.
- b. Establishing a time frame during which time sheets must be certified by the employee and supervisor and requiring that certifications be dated.

Department of Human Services Response:

- a. Agree. The Department will revise Timekeeping Policy V-4 to include required date fields for employee and supervisor signatures when certifying timesheets. The Division of Accounting will institute a new practice of reviewing a sample of timesheets from each district on a rotating basis to ensure certification. Required timesheets for the units selected for a designated month will be reviewed for the proper signatures and dates. All exceptions will be reported to the assigned timekeeper, the appropriate Office Manager and Division Director for follow-up.

Implementation date: March 2004.

- b. Agree. The Department will revise Timekeeping Policy V-4 to include a required timeframe for certification of timesheets. The timeframe established will be within 20 days after the close of a Kronos pay period.

Implementation date: March 2004.

Judicial Department

Introduction

Established by the State Constitution, the Judicial Department is a separate branch of the State's government. The Chief Justice of the Supreme Court is the head of the branch and is responsible for establishing administrative procedures for the following:

- Supreme Court
- Court of Appeals
- Trial Courts and Probation
 - 22 district courts
 - 64 county courts
 - 7 water courts
 - 23 probation departments
 - Denver Juvenile Court
 - Denver Probate Court

Several offices and committees within the Department operate outside the direction and control of the State Court Administrator to provide services under the Judicial Department. The Office of the Public Defender provides legal representation for the indigent. The Office of Alternate Defense Council provides representation for the indigent when there is a conflict with the Public Defender representing the individual. The Office of the Child's Representative ensures the provision of legal representation to children involved in judicial proceedings in Colorado.

In Fiscal Year 2003 the Department was appropriated approximately \$284.2 million and 3,228.3 full-time equivalent staff (FTE). The Department receives approximately 80 percent of its funding from the State's General Fund.

The following was prepared by the public accounting firm of Gelfond Hochstadt Pangburn, P.C. (GHP), which performed the Fiscal Year 2003 audit work at the Judicial Department.

Office of the Child's Representative

During the 2000 legislative session, the General Assembly passed House Bill 00-1371, which created the Office of the Child's Representative within the Judicial

Department. The Office is responsible for ensuring legal representation and nonlegal advocacy for children involved in judicial proceedings in Colorado. This includes enhancing the legal representation of children, establishing compensation for services, setting minimum practice and training standards, determining maximum caseloads, establishing oversight committees throughout the State, and working collaboratively with the state court-appointed special advocate (CASA) to develop local CASAs in each judicial district. The Office has 5 full-time equivalent administrative staff and 18 full-time contract employees that include attorneys and case workers. The Office receives its funding from general funded appropriations. Fiscal Year 2003 marks the second full year of operations for the Office.

Office of the Child's Representative Schedule of General Funded Expenditures - Budget Basis Years Ended June 30, 2002 and 2003		
Expenditure	2002	2003
Attorney services - by type of case:		
Dependency and neglect	\$ 5,349,032	\$ 5,516,225
Juvenile delinquency	1,203,240	981,246
Domestic relations	424,682	488,916
Truancy	172,982	113,082
Paternity	78,507	57,974
Probate	89,000	51,560
Other	27,001	14,600
Counsel expenses	5,286	6,773
Subtotal: Attorney services	7,349,730	7,230,376
Administrative and operating costs	449,404	434,927
Training	23,938	22,991
CASA services	20,000	20,000
Total general funded expenditures - actual *	7,843,072	7,708,294
Total general funded expenditures - appropriations	7,843,072	7,763,264
Variance - over (under) appropriations	\$ 0	\$ (54,970)
Source: Data obtained from the Office of the Child's Representative.		
* Does not include accrued payroll for June 2003 of \$98,886.		

Pursuant to House Bill 00-1371, GHP performed certain procedures at the Office of the Child's Representative, including the following:

- We obtained the Office's accounting policies and procedures for cash disbursements related to attorney payments and vendor payments, which cover the review and approval of disbursements, segregation of duties, and use of purchase orders for items over \$5,000. These office policies and procedures also provide that attorney payments are to be based on the terms of written contracts and fee schedules mandated by Chief Justice Directive 97-02.
- Using a statistical sampling method, we selected 36 cash disbursements totaling about \$15,000 from a population of 16,449 disbursements totaling \$6,126,162. The sample included 33 attorney payments totaling \$12,538 and 3 general vendor disbursements totaling \$2,370. We found that the invoices were in compliance with Chief Justice Directive 97-02. The invoices were recorded correctly on the Court-Appointed Counsel and State's accounting systems. We recalculated hourly bills and agreed contract billings to supporting documentation. We found that invoices had proper evidence that they were reviewed and approved for payment. For attorney disbursements, we reviewed supporting documentation for contract disbursements, noted written verification of appointment, and noted specific written approval for fees required over the maximum threshold for the type of case. For contracted attorneys, we noted that Form W-9s were maintained by the Office.
- We compared Fiscal Year 2003 payroll expenditures of \$1,295,323 as reported on a schedule of wages by employee with salary expenditures as reported on the State's accounting system and determined that amounts in these reports were in agreement. In addition, we selected 10 employees and agreed these employees' wages (which represented 57 percent of total wages) to contracts or authorization documents.
- We reviewed employee expense reimbursement reports and determined that expenses were within agency guidelines.

Based on procedures performed, we noted that the Office's "Fiscal Policies and Procedures Manual" states that the Office's goal is to process attorney payments within 30 days of receiving the invoice, under normal circumstances. We recalculated the timeliness of 33 attorney payments and noted that the Office did not meet its goal in eight cases: seven payments were made between 31 and 38 days, and one payment was made at 50 days.

Recommendation No. 10:

The Office of the Child's Representative should process attorney payments in accordance with its policy.

The Office of the Child's Representative Response:

Agree. Under normal circumstances the Office does process payments within 30 days. Payments referenced above exceeding the usual 30 day time period were delayed as a result of unusual circumstances, in which case the Office's policy does allow for additional processing time. In each circumstance the Office's attorneys were notified in advance of the anticipated delays in payment.

The first set of circumstances arose out of the need for approval of emergency supplemental funding by the Joint Budget Committee. The Office was legally obligated to hold warrants until the State Controller approved their release. This delayed payment of most invoices received in July 2002 to September 2002. Under normal circumstances payments would have been made in August 2002.

The second set of circumstances arose out of a severe staffing shortage. The Office is an office of only five staff. At virtually the same point in time, one staff member resigned unexpectedly, one staff member went out on unanticipated long-term emergency medical leave, and one staff member went out on planned maternity leave. The two remaining staff members did not have the ability or security clearance to immediately begin processing attorney payments. The Office processes such a large volume of payments that it is difficult to catch up if processing is suspended for even a short period of time. As a result, payments made after April 2003 were delayed by approximately 10 additional days. In order to better respond to unanticipated staffing shortages in the future, the Office implemented cross-training so that four staff members have the knowledge and ability to process payment.

Implementation date: October 15, 2003.

Department of Labor and Employment

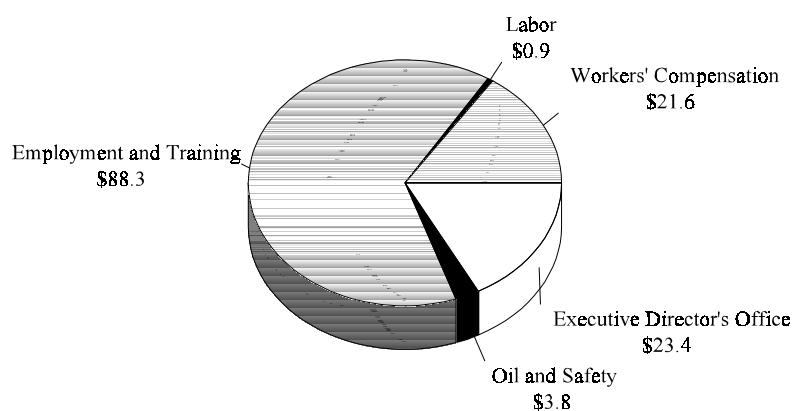
Introduction

The Department of Labor and Employment (DOLE) is responsible for providing services to employers and job seekers and enforcing laws concerning labor standards, unemployment insurance, workers' compensation, public safety, and consumer protection. The Department is composed of the following major organizational units:

- Division of Employment and Training
- Division of Workers' Compensation
- Division of Oil and Public Safety
- Division of Labor
- Executive Director's Office

The Department was appropriated \$138 million and 1,072.0 full-time equivalent staff (FTE) for Fiscal Year 2003. Approximately 26 percent of the funding is from cash funds and the other 74 percent is from federal funds. The following chart shows the operating budget by major organizational unit during Fiscal Year 2003.

Department of Labor and Employment
Fiscal Year 2003 Appropriations by Organizational Unit
(In Millions)



Source: Joint Budget Committee Fiscal Year 2004 Appropriations Report.

The following comments were prepared by the public accounting firm of Clifton Gunderson LLP, which performed the Fiscal Year 2003 audit at the Department of Labor and Employment.

Reconciliation of Expenditure Information

During Fiscal Year 2003 the Department administered 18 federal programs with \$92.1 million in federal expenditures. The Department incurs the following two types of federal expenditures:

- **Direct expenditures.** These expenditures are input into the State's financial accounting system, COFRS, and charged to the appropriate programs by the direct entry of vouchers, payroll-related expenses, and other accounting transactions. An automated system interfaces the expenditure information from COFRS into the Department's grant financial system, Financial Accounting and Reporting System (FARS).
- **Indirect expenditures.** These expenditures represent departmental overhead, such as finance, administration, and personnel costs. Indirect expenditures are calculated and recorded in FARS and then recorded into COFRS by Department staff through journal entries.

COFRS calculates earned federal revenue based on the federal expenditure information entered into the system. The Department operates on a reimbursement basis with the federal government; that is, the Department expends state funds for federal programs and then requests federal funds reimbursement based on the federal earned revenue calculated by COFRS. Reimbursement amounts due from the federal government are recorded as accounts receivable in COFRS.

At the end of each fiscal year, state agencies are required by the State Controller's Office to report federal expenditures, revenue, receivables, and cash receipts related to federal grants on a report, or "exhibit," entitled the Exhibit K – Schedule of Federal Assistance. State Controller's Office staff use information contained on the Exhibit Ks to prepare the State's Schedule of Expenditures of Federal Awards (SEFA), which is a required part of the State's annual financial and compliance audit report. The SEFA lists all federal financial assistance and federal cost-reimbursement contracts that the State receives during the year. The Department compiles its federal grant information for preparing the Exhibit K from its grant financial system (FARS) and reconciles all amounts to COFRS.

We found problems with federal expenditure and revenue information reported on FARS and COFRS at fiscal year-end 2003. Specifically:

- C While total Fiscal Year 2003 federal expenditures recorded in COFRS were approximately \$92.1 million, the federal revenue recorded in COFRS was \$93.3 million, or \$1.2 million higher. Since revenue is based on expenditures incurred and the Department's federal programs are 100 percent reimbursable programs, the revenue and expenditures in COFRS should agree. Federal grant expenditures recorded on COFRS and FARS were in agreement.
- C While the federal accounts receivable balance in FARS was approximately \$9.2 million at the end of Fiscal Year 2003, the federal receivable in COFRS was \$11.6 million, or about \$2.4 million higher. The federal receivable balances in the two systems should agree.

We also noted discrepancies between the Department's federal expenditure and revenue amounts recorded in FARS and COFRS during the Fiscal Year 2001 audit. While the Department agreed that it would analyze discrepancies between the two systems and review its reconciliation procedures by June 30, 2002, our findings indicate that the Department does not have an adequate reconciliation procedure in place to identify and resolve discrepancies in federal revenue and expenditure information entered into the two systems. The Department must institute reconciliation procedures for all federal expenditure and revenue information to ensure the information is reported accurately and to ensure the amounts requested for reimbursement from the federal government are accurate. Without a reconciliation, the risk of errors and irregularities rises to an unacceptable level.

Recommendation No. 11:

The Department of Labor and Employment should improve controls over federal expenditure and revenue reporting by implementing a periodic reconciliation process to identify and resolve discrepancies found between FARS and COFRS in a timely manner.

Department of Labor and Employment Response:

Agree. The Department of Labor and Employment has taken steps to improve controls over federal expenditure and revenue reporting including: (1) isolating the prior year balances in the federal receivables account, which will allow for the reconciliation of current and future years' activity and balances; (2) performing a detailed review of the process for recording revenue in COFRS, resulting in a change to this process and methodology to include periodic reconciliations of federal revenue and expenditures; (these changes are still being evaluated and revised); and (3) preparation of the

Exhibit K as of 12/31/03, including reconciliations between COFRS federal revenue and FARS expenditures, as well as deferred revenue in FARS and the federal receivable in COFRS. We also identified the amount of Statewide Indirect Cost Recoveries applicable to federal grants for the same time period. This has also been a contributing factor to the reconciliation problems in the past.

Implementation date: June 30, 2004.

Petroleum Storage Tank Fund Accounts Receivable

The Petroleum Storage Tank Fund (Fund) was created by Section 8-20.5-103, C.R.S., for the purpose of collecting registration and annual renewal fees from owners or operators of aboveground and underground storage tanks. In Fiscal Year 2003 the Fund had about \$514,000 in revenue from these fees. This revenue is used to reimburse eligible applicants for allowable costs incurred for removing petroleum contamination from underground and aboveground petroleum storage tanks, as well as for third-party liability expenses. The State Inspector of Oil, appointed by the Executive Director of the Department of Labor and Employment, collects registration and renewal fees and, in the case of delinquent fees, assesses a penalty of twice the amount of such fees and reasonable costs associated with the collection of such fees.

During our Fiscal Year 2003 audit, we noted a problem relating to the accounts receivable associated with these fees. Of the \$483,000 accounts receivable balance at June 30, 2003, approximately \$360,000 (about 75 percent) represents accounts over one year old. Approximately \$240,000 of the accounts are from 1998 to 2001. Additionally, approximately \$100,000 of the uncollected accounts results from the Department's not having correct information on the owner's name and billing address.

According to the Department of Personnel and Administration's Accounts Receivable Collections Administrative Rule, departments are required to send receivables to Central Collections when they become delinquent; delinquent accounts are defined by Central Collections as accounts 30 days past due. We found the Department currently has no process for routinely reviewing accounts receivable aging reports to determine when Fund accounts become delinquent and for submitting accounts to Central Collections at 30 days past due. Further, the Department has not instituted a procedure for the review of outstanding accounts to determine if names and addresses are correct. As a result, a number of delinquent

accounts submitted to Central Collections by the Department were sent back to the Department by Central Collections due to incorrect addresses and owner names.

The Department should establish policies and procedures for periodically reviewing aging analysis reports to identify accounts 30 days or more past due and submitting the delinquent accounts timely to Central Collections. In addition, the Department should require that the State Inspector verify owner names and billing addresses during required annual inspections and communicate any changes to the appropriate staff for corrections to the Department's records. Efforts in these areas would reduce the potential loss of revenue to the State and increase the efficiency of the State's collections process.

Recommendation No. 12:

The Department of Labor and Employment should improve controls over accounts receivable in the Petroleum Storage Tank Fund by:

- a. Establishing procedures for periodically reviewing aging analysis reports to identify delinquent accounts and submitting accounts 30 days past due to Central Collections.
- b. Obtaining verification of the owner name and address during the annual inspections and ensuring changes to the Department's records are made as needed.

Department of Labor and Employment Response:

Agree. The Division of Oil Inspection has attempted to clean up the information contained in the database. Most of the current information is valid, but there are still a number of "unknown" owners for facilities with outstanding invoices prior to 1/1/2001. The Director of the Division of Oil and Public Safety has approved a series of steps to collect the valid outstanding invoices and to write-off the uncollectible fees, including: (1) writing-off federal facility and "unknown" owner fee balances prior to 1/1/01; (2) waiving all late fees with invoices prior to 1/1/04, if the base fee has been paid; (3) providing amnesty for current billings and sending unpaid invoices to Central Collections after the amnesty period; and (4) creating the functionality in the system to refer unpaid fees to Central Collections electronically as they become 30-days overdue.

Implementation date: December 31, 2004.

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Department of Military and Veterans Affairs

Introduction

The Department of Military and Veterans Affairs consists of the Executive Director's Office, the Division of Veterans Affairs, the Army National Guard, the Air National Guard, and the Civil Air Patrol. The Adjutant General is the administrative head of the Department as well as the Chief of Staff of the Colorado National Guard. The Colorado National Guard is a federal and state military organization whose primary mission is to support the federal, state, and local governments in times of need.

Supervision

During a Fiscal Year 2001 financial review of the Department, we found that there was an inadequate segregation of duties between the billing and collection functions for the Tuition Assistance and the Contracting and Facilities areas. During our current audit, we found that the billing and collection duties have been segregated. The Tuition Assistance and the Contract and Facilities areas are responsible for billing, and the collection of these funds has transferred to the accounting office. However, we noted that additional efforts should be made by the Tuition Assistance Office to ensure adequate controls are in place over tuition refunds.

The State Tuition Assistance Program is a statutory program established under Section 23-5-111.4, C.R.S., to encourage enlistments, enhance the knowledge and skills of the National Guard, and retain membership in the National Guard. During Fiscal Year 2003, about \$386,000 was appropriated for tuition assistance, and approximately \$18,100 in receivables for tuition refunds, representing amounts due from approximately 24 individuals, were recorded by the Department at June 30, 2003. Repaid tuition refunds in turn are used to provide assistance to other eligible recipients.

Department regulations require that if a member of the Guard resigns or is discharged prior to completion of his/her membership obligation, the recipient shall be required to repay the amount of state tuition assistance not yet "earned." Regulations further require military personnel officers to notify the Tuition Assistance Office of pending discharges.

The Office uses several tools to identify discharged soldiers. For example, on a quarterly basis the Office receives an electronic listing of all soldiers in the Army National Guard who have been recognized as discharged at the federal level. The federal list is compared with records maintained within the Tuition Assistance Office in order to identify any discharged soldiers located in Colorado who received tuition assistance and did not meet the related service requirements. Once all discharges have been identified, the Office calculates how much the student owes the State, and sends an invoice to the student for this amount. According to the Department, the listings provided by the federal government can include about 650 names of discharged soldiers and may only contain the names of 12 or fewer Colorado soldiers that owe tuition refunds each year.

Department staff report that the Tuition Assistance Director is responsible for electronically sorting the information provided by the federal government, extracting the information on Colorado discharges, determining the amount owed, billing the soldier, and determining repayment terms. Repayment terms can vary; however, most soldiers are required to make full repayment within two years. If a soldier discontinues making payments, the receivable is turned over to the accounting department for further action. The Tuition Assistance Director meets with a supervisor weekly to discuss pertinent issues; however, the supervisor does not review the procedures performed by the Director. Although we did not note any errors or omissions during testwork, the lack of a supervisory review poses a concern because errors and irregularities may not be identified. For example, soldiers owing refunds may not be properly identified, or repayment amounts may not be accurately calculated. This puts the Department at risk for not receiving all monies due to the State.

Funding for the tuition assistance program has decreased from \$386,000 in Fiscal Year 2003 to \$175,803 in Fiscal Year 2004. Since the collections from tuition assistance refunds are reinvested into the program, the Department should ensure controls are adequate to accurately identify all refunds and request repayments as appropriate.

Recommendation No. 13:

The Department of Military and Veterans Affairs should improve its controls over the Tuition Assistance Office by establishing a supervisory review over the identification and calculation of accounts receivable for the tuition refunds owed to the State.

Department of Military and Veterans Affairs Response:

Agree. The Department will improve controls over the identification of persons who use Tuition Assistance funds but do not complete their service obligation and therefore owe the State a refund. We will implement the following procedural changes.

1. The Department archivist will manually compare the discharge roster with the database containing names of those who have used Tuition Assistance. The archivist will compare his list of matching names with the list developed by the Tuition Assistance Director (who uses the same independent process). Any differences will be reconciled.
2. The Tuition Assistance Director will use the reconciled list to calculate any refund due the State.
3. The Resource Manager (the supervisor of the Tuition Assistance Director) will review and sign the final list of names and amounts due and forward to the Controller.

Implementation date: January 1, 2004.

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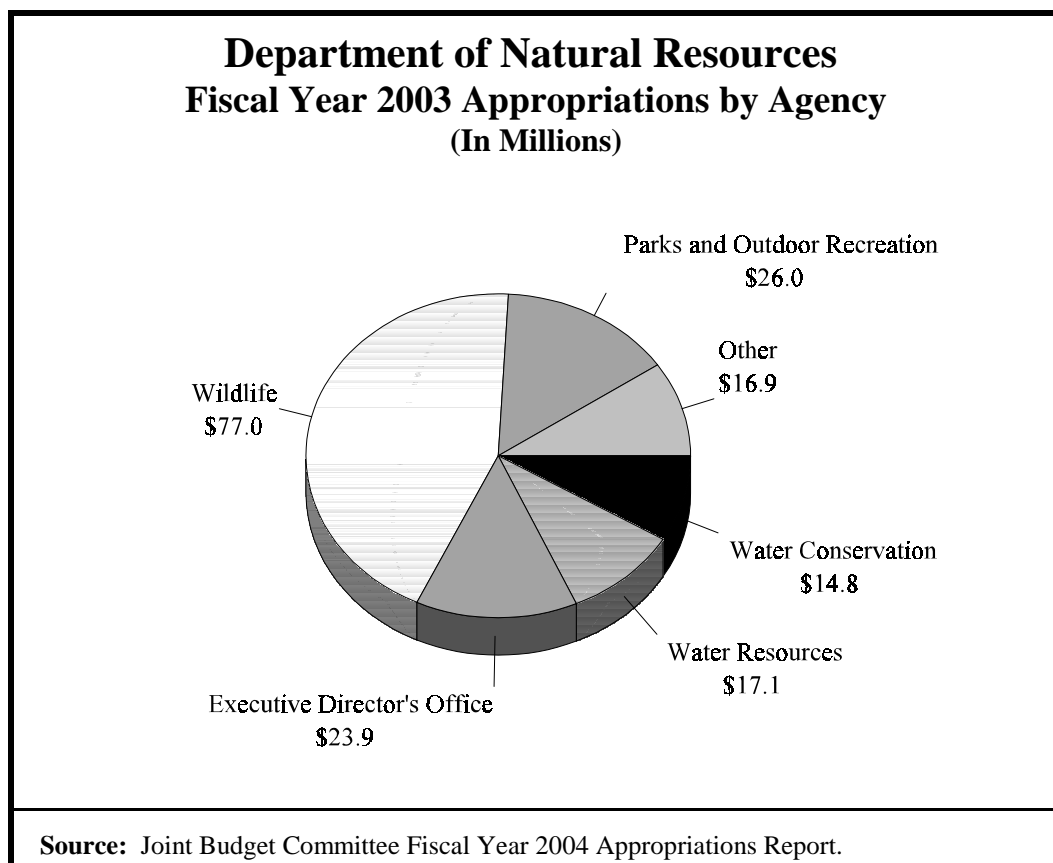
Department of Natural Resources

Introduction

The Department of Natural Resources is responsible for encouraging the development of the State's natural resources. Resources include land, wildlife, outdoor recreation, water, energy, and minerals. The Department comprises the Executive Director's Office, which is responsible for the administration and management of the overall Department, and the following eight sections:

- Wildlife
- Water Resources
- State Board of Land Commissioners
- Parks and Outdoor Recreation
- Oil and Gas Conservation Commission
- Division of Minerals and Geology
- Water Conservation Board
- Geological Survey

In Fiscal Year 2003 the Department was appropriated about \$175.7 million with 1,538 full-time equivalent staff (FTE). The Department is primarily cash-funded. Revenue sources include hunting, fishing, and other licenses, as well as royalties, rents, interest, and other sources. The following chart shows the Department's appropriations for Fiscal Year 2003.



Capital Assets Tracking

The Department is responsible for ensuring that its capital assets are properly recorded, inventoried, and safeguarded. Most of the Department's \$339.5 million in capital assets are located at various parks and wildlife facilities throughout the State. These assets include land, improvements to land, buildings, leasehold improvements, equipment, library books, historical treasures, and infrastructure such as roads, bridges, and dams.

Lack of controls over capital assets has been an ongoing issue at the Department. In Fiscal Years 1994 and 1997, we recommended that the Department improve its controls by completing annual physical inventories and properly adjusting accounting records based on the results of these inventories. In Fiscal Year 2002 we found problems with physical inventories, reconciliations to accounting records, capitalization thresholds, and useful lives for assets. In our current audit we found similar problems as follows.

- **The Department's central accounting office removed 81 items, totaling about \$1.3 million, from its internal database of capital assets without adequate documentation.** These items included vehicles, tractors, boats, and office equipment. The source of these adjustments came from hand written notes prepared by Division staff that simply stated that the items were "gone," or "not ours please remove." Adequate documentation should include a receipt evidencing the item was disposed of or sold, or include confirmation from the receiving agency for assets transferred. In addition, these deletions were not always made in a timely manner. For example, we noted three items Divisions had disposed of in Fiscal Year 2002 but that the Department did not delete from its internal records until the end of Fiscal Year 2003. Obtaining adequate supporting documentation and adjusting internal accounting records on a timely basis provides a means to safeguard assets and prevent fraud and misuse.
- **Assets were removed in error when new capitalization thresholds were adopted.** The Department increased its capitalization thresholds based on general guidelines established by the State Controller's Office. For example, the Department changed its thresholds for capitalizing buildings and leasehold improvements to \$50,000 or more. Prior to Fiscal Year 2003, the Department capitalized all building and leasehold improvements regardless of the acquisition value. We found that the Department incorrectly deleted three assets totaling \$403,000 from its internal database and the State's accounting system. Each of these items exceeded the \$50,000 capitalization threshold and should not have been deleted. This resulted in the Department's fixed assets being understated by \$403,000 at fiscal year-end.
- **The Department incorrectly recorded a gain on the disposal of assets when it revised the useful lives of its buildings from 27.5 to 40 years in Fiscal Year 2003.** The Department recalculated depreciation as if the lives of the buildings were originally set at 40 years and then reduced accumulated depreciation by approximately \$1.5 million and recorded a gain on disposal of assets of \$1.5 million. Generally accepted accounting principles state that if the useful life of an asset changes, the entity should depreciate the remaining cost proratably over the remaining extended life. Therefore, current year depreciation was understated for these buildings. The Department should recalculate depreciation on the buildings and make appropriate adjustments in Fiscal Year 2004. In addition, the Department could not provide us with sufficient information to determine the amount of the understatement. The Department did not correct its records as of fiscal year-end when we brought this matter to its attention.

- **The Department did not complete reconciliations in a timely manner.** The Department's policy is to perform quarterly and year-end reconciliations between the capital assets recorded on an internal database and the State's accounting system. Quarterly reconciliations were not completed and the year-end reconciliation was completed almost four months after the books were closed. Based on the year-end reconciliation, at June 30, 2003, about \$266,000 was erroneously classified as leasehold improvements instead of equipment, and accumulated depreciation was overstated by \$1,400 on the State's accounting system. Due to the late completion of the year-end reconciliation, these items were not corrected until Fiscal Year 2004. In addition, the final year-end reconciliation between the State's accounting system and the Department's internal listing was not complete because it contained an unresolved difference of approximately \$60,000. Timely completion of quarterly reconciliations would expedite the completion of the final reconciliation at year-end.
- **We found no evidence of an independent review.** When independent reviews of the reconciliations are not performed, the risk increases that errors will go undetected or that reconciliations will not be completed timely.

The significant amount of capital assets held by the Department and the disbursements of these assets throughout the State require that the Department have adequate controls in place to ensure that assets are safeguarded and that the risk of errors or irregularities is minimized.

Recommendation No. 14:

The Department of Natural Resources should improve controls over capital assets and ensure assets are recorded accurately on the State's accounting system by:

- a. Entering all Fiscal Year 2003 adjustments to capital assets as needed.
- b. Requiring divisions to submit inventory adjustments, including adequate documentation, to the Department within a reasonable time after an asset is added or deleted; reviewing the documentation for completeness; and following up as appropriate.
- c. Ensuring adjustments made when revising capitalization thresholds are accurate.

- d. Recording depreciation and adjusting the remaining useful lives of capital assets in accordance with generally accepted accounting principles when changing the estimated useful lives of assets.
- e. Completing periodic reconciliations between the internal database of capital assets and the State's accounting system and making adjustments in a timely manner.
- f. Implementing independent review procedures over the reconciliation process.

Department of Natural Resources Response:

- a. Agree. Adjustments completed January 2004.

Implementation date: January 2004.

- b. Agree. Divisions are already required to submit physical inventory verification at year-end. The Department will reinstitute a process of the Department deputy director notifying division directors of units that have not complied. In addition, the Department will implement a new procedure requesting divisions to complete an asset change form and supporting documentation any time a capital asset is transferred, disposed of or stolen. This form and supporting documentation will also be required for any variances noted on the year end inventory verification.

Implementation date: June 2004.

- c. Agree. 2003 adjustments have been completed. In the event of any future revisions to capitalization thresholds all adjustments will be thoroughly reviewed and verified before posting.

Implementation date: February 2004.

- d. Partially agree. Adjustments to the useful lives of certain capital assets was done as the result of an Fiscal Year 2002 audit recommendation. Implementation of this recommendation required a very large commitment of resources for little value. The net adjustment was less than 0.5 percent of the total capital asset valuation. Although the Department acknowledges that the methodology used to adjust the useful lives of certain assets was applied incorrectly, the Department does not intend to commit the resources to recalculate and adjust previously

adjusted assets. Any future adjustments will be made in accordance with the methodology required by the audit.

Implementation date: March 2004.

- e. Agree. Reconciliations and adjustments for Fiscal Year 2004 have been completed through 2nd quarter (December 31, 2003) and are being completed on a quarterly basis.

Implementation date: January 2004.

- f. Agree. Summary data which was the result of the reconciliations was reviewed prior to any adjustments being posted. Effective with the 3rd quarter 2004 reconciliation, all supporting reconciliation documents and worksheets will be reviewed along with the summary support prior to adjustments being posted.

Implementation date: April 2004.

Division of Minerals and Geology

The Division of Minerals and Geology is responsible for regulating the mining activities in the State. This primarily includes overseeing the safety and environmental soundness of mining operations. When mining is complete, the Division is also responsible to ensure that the mine operators return the land to its original state. The program is functionally divided up among coal, minerals, mines, and inactive mines.

Reclamation Deposits Held in Custody

As of June 30, 2003, the Division of Minerals and Geology had approximately \$13.4 million of reclamation deposits held in custody. These deposits, which include \$9.2 million in cash and \$4.2 million in certificates of deposit, provide assurance that mine operators are financially capable of reclaiming the land used in the mine operations. Section 34-32-117, C.R.S., authorizes the Division to collect these funds from mine operators. If the operator does not reclaim the land to its original state, the Division is allowed to use the deposit to cover reclamation costs. If the land is properly reclaimed, the Division refunds the deposit to the operator.

The Division establishes amounts that operators must deposit. The operator can secure these reclamation deposits with cash, or a certificate of deposit as collateral. Section 34-32-127, C.R.S., requires the Division to turn over these reclamation deposits to the State Treasurer's Office (Treasury) for safekeeping. When secured with cash, the Division deposits the cash with Treasury for safekeeping and investment. The Division tracks the earned interest and returns the entire balance, including earned interest, to the operator upon reclamation or replacement.

For reclamation deposits secured with certificates of deposit, the Division records only the face amount of the certificate and deposits the certificate with Treasury. Once reclamation is complete, the Division collects the certificate of deposit from Treasury, updates its records, and returns the item to the operator. Interest earned on the certificates belongs to the operator. Interest is paid to the operator on an ongoing basis over the term of the certificate or accumulates in the account until the certificate matures.

As part of our audit, we reviewed the Division's controls over reclamation deposits held in custody and found several weaknesses. Specifically, we found that the Division does not have (1) procedures to resolve exceptions with confirmations of certificates of deposit received from financial institutions and update accounting records, (2) adequate segregation of duties over reclamation deposits held at Treasury, or (3) an adequate process for reconciling its internal records of reclamation deposits with the State's accounting system.

Confirmation of Certificate of Deposit

As of June 30, 2003, the Division reported that it had \$4.2 million in certificates of deposit. At year-end, the Division sends confirmations to financial institutions to verify that the certificates of deposit are on hand at various institutions as well as verify the amounts of the certificates. For Fiscal Year 2003, the Division reported that it sent confirmations for all 357 certificates of deposit held with financial institutions. However, the Division does not resolve all discrepancies between its internal records and those of financial institutions and make necessary adjustments to the State's accounting system.

As shown in the following table, according to the Division's records, 87 of the 357 confirmations, or 24.4 percent, showed discrepancies between information reported by the financial institution and what was recorded on the Division's internal records. According to the Division's records, these 87 certificates of deposit had a value of more than \$769,000. In 14 of the 87 instances, the confirmations suggest the certificates may not exist.

Division of Minerals and Geology Summary of Confirmations on Certificates of Deposits Returned With Exceptions Fiscal Year Ended June 30, 2003			
Reasons Confirmation Returned With Exceptions	Certificates With Exceptions	Division's Records	Financial Institution's Records
Financial institution reported a different dollar amount	73	\$711,938	\$724,270
Certificates reported as previously redeemed	5	\$ 37,432	\$ 0
Financial institution had no record of certificate	8	\$ 19,500	\$ 0
Financial institution had closed	1	\$ 500	\$ 0
Total confirmations with exceptions	87	\$769,370	\$724,270
Source: Summary of the Division's analysis of confirmations.			

In most cases, the discrepancies between the Division's and the financial institutions' records appear to be related to problems with the Division's procedures for confirming these certificates. First, the Division did not confirm the balance at June 30, 2003. Instead, the Division sent their confirmations on April 1, 2003, and requested that financial institutions respond by May 3, 2003. As a result, it was not possible to determine the date that the financial institution used for reporting the amount. Second, the Division requested that the financial institution confirm the account balance, not the face value of the certificate. The Division's records reflect only the face amount of the certificate. Therefore, the majority of the 73 exceptions related to discrepancies in the values of the certificate of deposit may have resulted because amounts confirmed by the financial institution included accrued interest or bank charges, or because the bank combined accounts.

The Division's internal policy states that no interest shall accrue onto the principal. As noted above, we found that the majority of discrepancies may have resulted because the amount confirmed included accrued interest. This indicates the Division is not enforcing its policy. We also found that the Division did not update its internal records for all changes in the financial institutions' name or the account numbers. The Division reported that because of the long-term nature of mining operations, deposits can be held for up to 30 years.

The most serious concern involves certificates worth \$57,432 that the Division maintains it has; however, the confirmations do not reflect the existence of the certificates. These confirmations include five certificates that were redeemed but

remain on the Division's list, eight certificates that the financial institutions reported they did not have, and one certificate from a financial institution that had closed. The Division was unable to provide information on whether these certificates were redeemed as a result of the operator properly reclaiming the land or redeemed by the Division for reclamation purposes, or if the certificate was improperly redeemed. One such certificate was reported as redeemed in 1996 yet remains on the Division's internal list. No additional procedures were performed by the Division to ascertain the status of these certificates.

The Division needs to strengthen controls over certificates of deposit held by financial institutions by improving its confirmation process, identifying the reasons for discrepancies and resolving them, and adjusting its internal records and the State's accounting system as appropriate.

Segregation of Duties

As of June 30, 2003, the Division reported reclamation deposits of \$9.2 million in cash held in custody on the State's accounting system in addition to the \$4.2 million in the form of certificates of deposit. We reviewed the Division's procedures over the transfers of these reclamation deposits to the State Treasurer's Office for safekeeping. We found the following problems:

- **The Division lacks adequate segregation of duties.** The two individuals responsible for updating and reconciling the Division's lists of reclamation deposits held in custody also have the authority to withdraw the items from Treasury. Lack of segregation of duties between individuals recording reclamation deposits and those individuals with access to these deposits creates a risk of errors going undetected or possible misappropriation of state assets.
- **Signature cards have not been updated.** We reviewed the Division's signature card at Treasury and found it had not been updated since May 1999. Individuals listed on the signature card have authority to deposit or withdraw the Department's reclamation deposits from the State Treasurer's Office. The card contained eight names, including an employee who had not worked at the Division since June 2000 and, therefore, should not have authority to have access to these assets.
- **Receipts for reclamation deposits placed at Treasury for safekeeping are not kept in a secure location and tracked.** We found that receipts issued by Treasury for the \$13.4 million of deposits held in custody are stored on unlocked shelves in the Division's hallway. When the Division refunds or cashes in a reclamation deposit, the receipt is given to Treasury in return for the deposit. No control sheets are used to track the receipts and deposits

withdrawn. In addition, we found no evidence of review to ensure that the deposits were appropriately withdrawn and deducted from the Division's listing and the State's accounting system.

Reconciliation of Reclamation Deposit Information

During our 1999 audit, we found problems with the Division's procedures for reconciling the Division's reclamation deposit records to the State's accounting system and investigating and resolving discrepancies on a monthly basis. The Division agreed with the recommendation and planned to have it implemented by December 1999. However, it was not until Fiscal Year 2001 that the Division fully implemented this recommendation. In our current audit, we found problems with the Division's procedures for reconciling the Division's reclamation deposits similar to those problems identified in 1999. Specifically, we found that reconciliations are not completed timely and copies are not always maintained.

During our current audit, the Division could not provide monthly reconciliations between its internal listing, Treasury's listing, and the State's accounting records for \$9.2 million of cash reclamation deposits. Division staff stated they completed these reconciliations but did not maintain copies. Division staff did not complete the fiscal year-end reconciliation of the \$4.2 million of certificates of deposits until September 2003. Upon completion of this reconciliation, the Division's internal listing showed \$1,000 more than the amounts recorded on the State's accounting system and on Treasury's listing. Additionally, we found no evidence of an independent review to ensure that these reconciliations and related adjustments, if any, were completed timely and accurately.

It is important that the Division safeguard the State's assets and report reliable information on the State's financial system for all reclamation deposits held in custody. Further, it is the Division's responsibility to hold operators accountable for the reclamation of the land used for mining, and these deposits help ensure that this occurs. Therefore, the Division should take steps to address all weaknesses in controls over reclamation deposits held in custody.

Recommendation No. 15:

The Division of Minerals and Geology should improve its controls over reclamation deposits held in custody by:

- a. Ensuring that confirmation forms used for certificates of deposit held by financial institutions include all necessary information such as the date of

- confirmation, face value of the certificate, and requests for updated information on the institution's name or address.
- b. Developing and implementing procedures to identify and resolve all exceptions related to certificates of deposit between internal records and information reported by financial institutions. These procedures should include documentation requirements, timely reviews, and appropriate adjustments to the State's accounting system.
 - c. Enforcing its policy stating that no interest shall accrue on reclamation deposits held by financial institutions by working with the operators and financial institutions, or changing its policy.
 - d. Establishing and implementing adequate segregation of duties between individuals who maintain records of reclamation deposits and individuals authorized to withdraw these deposits from Treasury. In addition, the Division should update the signature card on file with the State Treasurer's Office.
 - e. Ensuring that receipts for reclamation deposits with Treasury are safeguarded and that withdrawals of items and the related adjustments to the Division's internal listings are completed timely and accurately.
 - f. Reconciling internal records on reclamation deposits held at Treasury to the State's accounting system and Treasury's records, and implementing independent review procedures over these reconciliations in a timely manner.

Department of Natural Resources Response:

- a. Agree. The letter sent to financial institutions requesting confirmation of certificates of deposit will be modified for the next submittal in order to capture the information noted. Revised confirmation letters will be sent to the financial institutions by May 2004.

Implementation date: May 2004.

- b. Agree. The Division developed and implemented exceptions procedures in January 2004 that address documentation requirements and timely reviews, and includes an explanation of what types of actions require Mined Land Reclamation Board decisions (the Board meets once a month). The 14 exception items that were not confirmed with financial institutions have been researched by the Division and the following actions were taken by February 24, 2004:

- Bank information was updated in the Division's internal records (1 item).
- Division requested the banks to investigate redemption of certificates of deposits not approved by the Division (2 items).
- Revocation or release actions are scheduled for the February, March or April board meetings of the Mined Land Reclamation Board (11 items).

Implementation date: June 2005.

- c. Agree. The program manager for the Minerals Program will investigate a possible rule change, within statutory guidelines, and Mined Land Reclamation Board policies. If a rule change is not advisable, the Division will contact financial institutions once a year, following the certificates of deposit confirmation process, requesting that they distribute the interest to the mine operator.

Implementation date: August 2004.

- d. Agree. The Division updated the signature card on file with the State Treasurer's Office, which eliminates the ability of the individuals who record the deposits from also being able to withdraw the deposits from Treasury. Also, a locked cabinet was installed to house the deposit records, which cannot be accessed by the individuals who can withdraw deposits from Treasury. These actions guarantee the recommended segregation of duties. Separate files for new deposits going to Treasury and existing deposits withdrawn temporarily are established to help track the items being deposited with Treasury.

Implementation date: December 2003.

- e. Agree. The Division installed a locked cabinet to secure the deposit records, which cannot be accessed by the individuals who can withdraw deposits from Treasury. Separate files for new deposits going to Treasury and existing deposits withdrawn temporarily are established to help track the items being deposited with Treasury.

The program manager for the Minerals program will be signing off (started in January 2004) on the monthly reconciliations of Division listings versus Treasury listings of deposits, which will ensure the timeliness and accuracy of listings.

Copies of monthly reconciliations will be kept on file in the Division starting in January 2004.

Implementation date: January 2004.

- f. Agree. New procedures for independent reviews are as follows:
- The program manager for the Minerals program will review the monthly reconciliation of deposits.
 - A budget and policy analyst will review the monthly cash bonds reconciliation.
 - Copies of monthly reconciliations will be kept on file in the Division.
 - Reviewers will monitor the timeliness of withdrawal and deposits of financial warranty instruments with the State Treasurer.

Implementation date: January 2004.

Colorado Water Conservation Board

The Colorado Water Conservation Board (CWCB) is the State's primary water policy and planning agency. The statutory duty of the Board is to promote conservation of the State's waters and to assist in flood prevention. One program that helps the Board meet its statutory duty is the Construction Fund Loan Program. This program provides loans from its revolving fund for projects that will either increase the beneficial consumptive use of Colorado's undeveloped compact-entitled waters and/or repair or rehabilitate existing water storage and delivery systems. The Board, with the approval of the General Assembly, authorizes loans to local governments, water districts, and private companies for a variety of projects that are important to water conservation in Colorado. Since its inception in 1971, the Board has disbursed over \$214 million for over 256 water projects. As of June 30, 2003, CWCB had 222 loans in repayment status totaling \$162.5 million.

Compliance With Liability Insurance Requirements

The Board requires borrowers to maintain general liability insurance from the time of contract execution until their loan is repaid. Requiring borrowers to maintain liability insurance protects the State's interests should an unforeseen event at a project site impact a borrower's ability to pay its obligations. In addition, for contracts dated 1995 and later, the State must be named as an additional insured on the general liability insurance policy. To comply with these insurance requirements, borrowers must provide the Board with a certificate of insurance (including an additional insured endorsement) and documentation of policy renewal, as needed, throughout the life of the loan.

During our 1998 Colorado Water Conservation Board Construction Fund Loan Program performance audit, we found that in 41 of 154 active loans (27 percent) there was no evidence that the borrower had obtained the required liability insurance. In addition, we observed issues with the internal loan review process and recordkeeping. We found that files were missing evidence that sufficient liability insurance had been obtained. We observed that these problems could have been identified and corrected if the Board had an internal review process and better file maintenance procedures. Therefore, we recommended that the CWCB ensure that borrowers comply with the general liability insurance requirements and establish a process for reviewing each loan prior to disbursing project funds and at various times thereafter. The Department agreed with our recommendations and planned to develop procedures to ensure that borrowers comply with the liability insurance requirements. The procedures were to be implemented by January 1, 2000.

During our current audit, we reviewed 25 contracts dated between 1999 and 2002 to determine if these recommendations had been implemented. We noted that current certificates of liability insurance were not on file for 17 contracts out of 25, or 68 percent, of the selected sample as follows:

- For five contracts the liability insurance expired in 2001.
- For eight contracts the liability insurance expired in 2002.
- For three contracts the liability insurance expired on March 1, 2003.
- For one contract the liability insurance expired on June 1, 2003.

The outstanding loan balances of the 17 contracts totaled approximately \$31.3 million. Missing evidence of liability insurance appears to be attributable to the following factors:

- Inadequate monitoring procedures to identify borrowers who are delinquent in meeting the liability insurance requirements. Such monitoring could be done using the reporting capabilities within the Access database.
- Lack of standard procedures for following up with borrowers who are delinquent in meeting the liability insurance requirements.

As a result of our audit, the CWCB reviewed the 17 loan files and obtained current certificates of liability insurance from borrowers with expired liability insurance for Fiscal Year 2003. Because the period of coverage for the majority of the certificates of liability insurance is one year, these certificates should be renewed by the borrowers annually and forwarded to the CWCB for the term of the loan. If current certificates

of liability insurance are not obtained, the CWCB may not be insured against borrowers' default on loan repayments.

Recommendation No. 16:

The Water Conservation Board should improve its monitoring of borrowers' compliance with the liability insurance requirements by:

- a. Extending testwork to review all the outstanding loan files to identify instances in which the borrower does not meet insurance requirements and following up to ensure compliance.
- b. Utilizing Access database reporting capabilities to monitor liability insurance expiration dates by borrowers on a monthly basis.
- c. Developing procedures for following up in a timely manner with all borrowers who are delinquent in meeting insurance requirements.

Department of Natural Resources Response:

Agree. This recommendation had been implemented by September 1999. The CWCB staff had performed an analysis and review of all insurance requirements and updated the certificates on file. Then, a procedure had been implemented to request any expired certificates of liability insurance on a monthly basis. By June 2000, another procedure had been implemented to ensure that no loan disbursements were made unless a current certificate was on file.

Operational changes have occurred at CWCB over the past two years that impacted administrative functions. As a result, insurance compliance was not being performed on a monthly basis due to its time-consuming nature. Hence, the numbers of certificates not on file during the spot audit.

CWCB is currently putting this procedure back into place and expects to accomplish this by June 2004. Additionally, if CWCB, Water Supply Planning and Finance could establish an administrative position to include this as one of the duties, this procedure could be fully implemented at all times.

Implementation date: June 2004.

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Department of Personnel and Administration

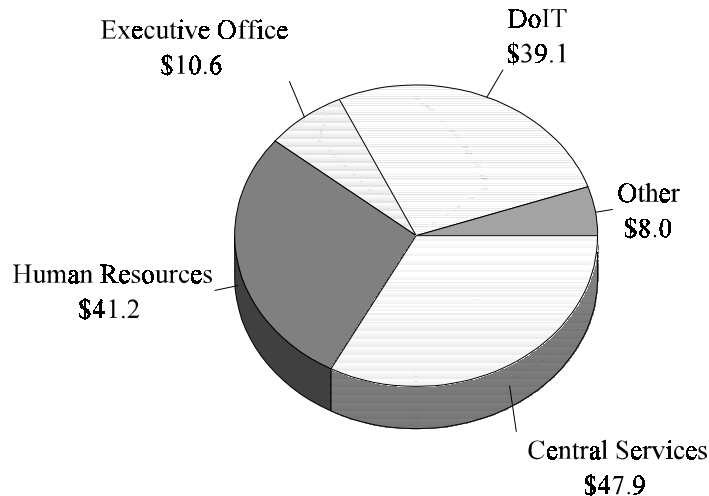
Introduction

The Department of Personnel and Administration's primary function is to support the business needs of state government. The Department administers the classified personnel system, which includes approximately 27,000 full-time employees (excluding the Department of Higher Education), and provides general support services for other state agencies. The Department of Personnel and Administration includes the following divisions:

- Executive Office
- Human Resources
- Personnel Board
- Central Services
- Finance and Procurement
- Information Technologies (DoIT)
- Administrative Hearings

The Department was appropriated total funds of \$146.8 million and 585 full-time equivalent staff (FTE) for Fiscal Year 2003. Approximately 8 percent of the funding is from general funds and 92 percent is from cash funds. Cash funds include, but are not limited to, vehicle and building rentals, copying, printing, graphic design, and mail services. The following chart shows the operating budget by division during Fiscal Year 2003.

**Department of Personnel and Administration
Fiscal Year 2003 Appropriations by Funding Source
(In Millions)**



Source: Joint Budget Committee Fiscal Year 2004 Appropriations Report.

Ensure Review of Payroll Information

In Fiscal Year 2003 the Department of Personnel and Administration's annual gross payroll was approximately \$28.5 million for its 539 full-time and part-time employees. During our Fiscal Year 2003 audit, as part of our review of controls over the payroll process, we tested 60 employee files to determine if information provided by employees on the W-4 (tax withholding) forms agreed with the information on the Colorado Personnel Payroll System (CPPS). We found three instances in which there were inconsistencies:

- In one instance the number of personal allowances indicated on the W-4 form did not agree with the information on CPPS. This resulted in \$45 less in tax being withheld from the employee's paycheck for one month.
- In two instances a specific dollar amount deduction designated by the employee on the W-4 did not agree to the deduction amount on CPPS. In one instance this resulted in a total of \$50 less in tax being withheld from the employee's paycheck for two months. In the other instance \$300 too much in tax was withheld from the employee's paycheck from June through November 2003.

We found similar problems during our Fiscal Year 2002 audit. The Department agreed with our recommendation and in September 2002 required that all Department employees resubmit a W-4 form to ensure that accurate information was on file with the Department. While we noted that the Department collected new W-4 forms from the majority of employees, it appears that they were not consistently used to ensure accuracy.

Payroll is a highly sensitive area. The Department needs to ensure that appropriate controls are in place.

Recommendation No. 17:

The Department of Personnel and Administration should ensure that withholding information documented in employee payroll files is accurately recorded in the Colorado Personnel Payroll System.

Department of Personnel and Administration Response:

Agree. The Department has implemented procedures to ensure W-4s are correctly completed and recorded.

Implementation date: Implemented.

State Fleet Management

Section 24-30-1104 (2), C.R.S., requires that all vehicles purchased after July 1, 1992, within the State's executive branch be owned by the Department of Personnel under the Division of Central Service's State Fleet Management program and be leased and permanently assigned to state agencies. State Fleet Management is required to maintain, store, repair, dispose of, and replace state-owned motor vehicles and establish and maintain a centralized record-keeping system for the acquisition, operation, maintenance, repair, and disposal of all motor vehicles in the fleet.

Physical Inventory

During Fiscal Year 2003 the State Fleet Management program purchased 459 vehicles totaling about \$8.4 million; as of June 30, 2003, Fleet had capital assets of about \$102.8 million. These capital assets consist of about 5,670 vehicles, totaling about \$102 million, and about 700 vehicle attachments, totaling about \$800,000. Attachments consist of items affixed to vehicles, such as light bars for State Patrol vehicles. State Controller's Office guidelines state that a physical inventory should be conducted annually at or near year-end for all capital assets. We found that Fleet Management did not conduct a physical inventory in Fiscal Year 2003 and was unable to recall the last time an inventory was performed.

Most of Fleet's vehicles are in the possession of other state agencies. State agencies are required to report monthly activity for vehicles that had some type of usage or repair work during the month. This monthly activity, such as mileage readings, fuel usage, maintenance and repairs, is tracked by Fleet for each vehicle through the Colorado Automotive Reporting System (CARS). While these reports provide information to Fleet for monitoring actively used vehicles, they do not provide adequate evidence that the vehicles were in the possession of the agencies at month- or year-end. In addition, Fleet does not require reports for vehicles where no activity has been reported for extended periods of time such as three months or longer, nor does Fleet inventory vehicles located on its lot on a routine basis.

Since these vehicles and attachments are the property of the State and Fleet is responsible for safeguarding these assets, it is important that Fleet have adequate controls in place to determine that the capital assets exist and are properly accounted for on the State's records.

Recommendation No. 18:

The State Fleet Management program should implement year-end physical inventory procedures that include:

- a. Performing physical inventories of all capital assets, including obtaining signed reports annually from agencies that have been assigned Fleet Management vehicles attesting that such vehicles and attachments exist and are in their possession.

- b. Comparing the results of the physical inventories with the Colorado Automotive Reporting System (CARS) and the State's accounting system. Discrepancies should be identified, adequate documentation should be obtained to resolve these discrepancies, and appropriate adjustments should be made to CARS and the State's accounting system.

State Fleet Management Response:

Agree. Because State Fleet Management receives monthly operational data (frequently from third parties: repair shops, fuel stations, etc.) on virtually all vehicles, we can enable the CARS system to extract a report that lists all vehicles for which there was no fuel purchased, no mileage reported, or no maintenance performed. At the end of each year this list can be sent to departmental Fleet coordinators to verify and sign-off on possession of the vehicles for which there are service data gaps. We would expect there to be very few vehicles remaining on such a list.

We feel this would be more reliable and efficient than sending a master vehicle list to departmental Fleet coordinators and asking them to verify and sign off on the possession of all of the vehicles on that list. While this can be done, we are concerned that too many coordinators might be tempted to simply sign off rather than actually verify their assets.

Implementation date: July 2004.

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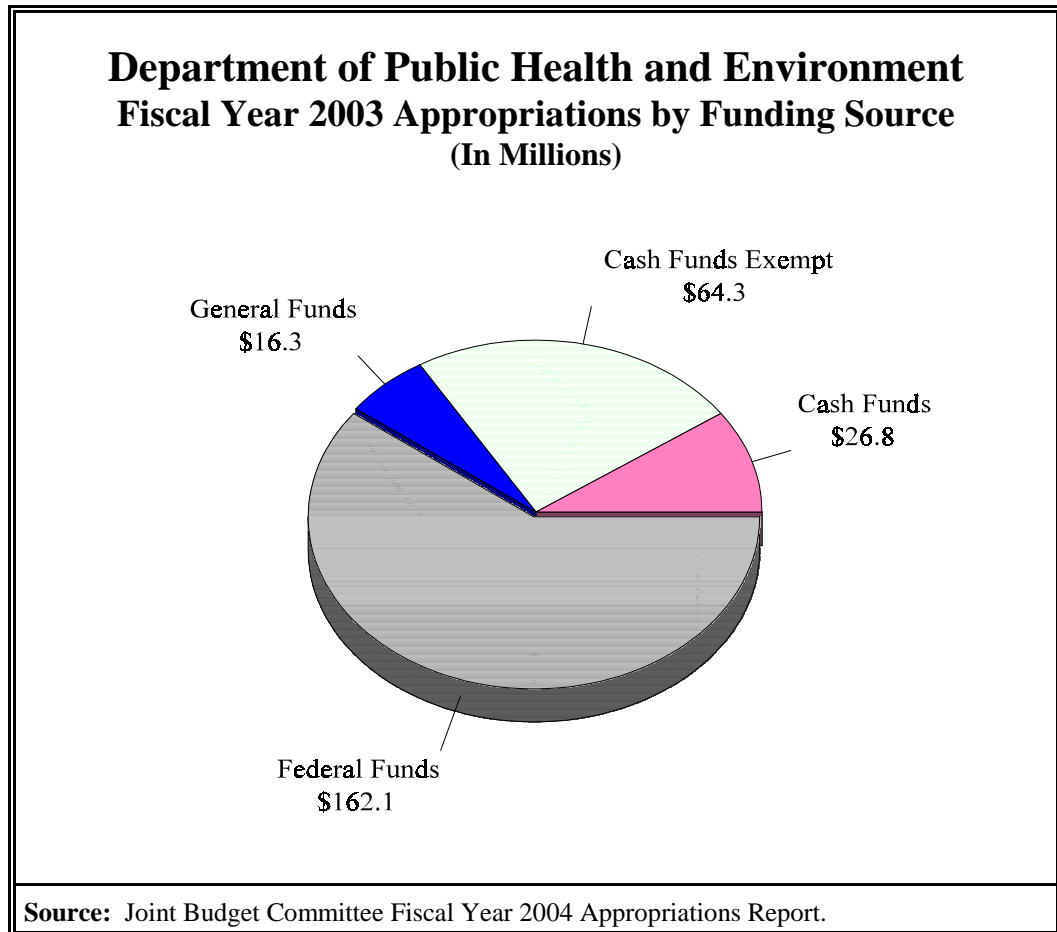
Department of Public Health and Environment

Introduction

The Department of Public Health and Environment is responsible for improving and protecting the health of the people of Colorado, maintaining and protecting the quality of Colorado's environment, and ensuring the availability of health and medical care services to individuals and families. The Department is composed of the following major organizational units:

- **Administrative Divisions**
 - Administration and Support
 - Center for Health and Environmental Information
 - Laboratory and Radiation Services
 - Local Health Services
- **Environmental Divisions**
 - Air Quality Control
 - Water Quality Control
 - Hazardous Materials and Waste Management
 - Consumer Protection
- **Health Services Divisions**
 - Health Promotion and Disease Prevention
 - Disease Control and Environmental Epidemiology
 - Health Facilities
 - Prevention and Intervention Services for Children and Youth

The Department was appropriated \$269.5 million and 1,104 full-time equivalent staff (FTE) for Fiscal Year 2003. The following chart shows the operating budget by funding source during Fiscal Year 2003.



The following comments were prepared by the public accounting firm of Terry & Stephenson, P.C., which performed the Fiscal Year 2003 audit work at the Department of Public Health and Environment.

Colorado Children's Trust Fund

In accordance with Section 19-3.5-105(1)(I), C.R.S., certain procedures were performed related to the Colorado Children's Trust Fund.

During the 1989 legislative session, the General Assembly passed House Bill 89-1216, which created the Colorado Children's Trust Fund (CCTF). In 2000, House Bill 00-1025 allocated the Trust Fund to the Colorado Department of Public Health and Environment. The purpose of the Trust Fund is to prevent child abuse and neglect. This includes reducing the incidence of child abuse and neglect for Colorado's children and reducing the need for state intervention in child abuse and neglect prevention and education. The Trust Fund issued 15 grants during Fiscal

Year 2003. The Trust Fund had 2.1 full-time equivalent staff and received most of its funding from the dissolution of marriage docket fee, federal grants, and interest. Federal funds were transferred from the Department of Human Services pursuant to House Bill 00-1025. These funds were from the Community-Based Family Resource and Support grant award that is available for expenditures made in accordance with Sections 201 through 202 of Title II of the Child Abuse Prevention and Treatment Act.

Colorado Children's Trust Fund Schedule of Revenue and Expenditures For the Fiscal Year Ending June 30, 2003	
Revenue	
Federal Grants	\$ 101,990
Dissolution of Marriage Docket Fee	338,985
Interest Income	46,191
Donations	2,972
<i>Total Revenue</i>	<i>490,138</i>
Expenditures	
Grants and Contracts	372,173
Personal Services	148,379
Operating Expenses	7,743
Professional Services	7,000
Indirect Costs	36,355
<i>Total Expenditures</i>	<i>571,650</i>
Excess of Expenditures over Revenue	(81,512)
Intergovernmental Transfer ¹	(980,396)
Decrease in Fund Balance	(1,061,908)
Total Unrestricted Fund Balance, beginning	1,280,995
Total Unrestricted Fund Balance, ending	\$ 219,087
Source: Data obtained from the Department of Public Health and Environment.	
¹ Under Senate Bill 03-191, \$980,396 was transferred from the Trust to the General Fund.	

We conducted an analytical variance analysis on all accounts by comparing the balances as of June 30, 2003, and June 30, 2002. We noted one significant decrease in fund balance between June 30, 2003, and June 30, 2002, due to an intergovernmental transfer of \$980,396 from the Trust to the General Fund in accordance with Senate Bill 03-191.

We reviewed the procedures applicable to internal controls over revenue and cash disbursements for the Colorado Children's Trust Fund. In addition, we tested the Trust's compliance with internal controls, including salary and related benefit costs and contractor and grant disbursements. Two revenue receipts, two cash disbursement payment vouchers, and one employee were selected for testing in order to determine compliance with internal controls. There were no exceptions noted in the review of internal controls.

We reviewed the Trust's site visit reports for the six newly funded programs for Fiscal Year 2003 to determine the Trust's compliance with its policy requiring all newly funded programs to have a site visit. Each report was reviewed to verify it included a review of program progress, contract compliance, fiscal records, and a discussion of program implementation and sustainability. There were no exceptions noted in the review of the site visit reports.

In addition, funded programs are required to submit a six-month progress report by January 31 and year-end report by July 31. We obtained the six-month and year-end reports for five programs. We reviewed each report to verify that it included a summary of the program's number of clients, outcome of the program, and an expenditure report, and that the report was submitted timely.

We noted that Prowers County Department of Social Services had not responded to questions on the six-month report and had not submitted a year-end report. As a result, the Trust did not issue the second and third grant payments. The remaining four reports were reviewed without exception.

Administrative Expenditures

During our procedures we found that CCTF expenditures exceeded revenue by about \$81,000, or about 17 percent. If expenditures continue to exceed revenue at this rate, the fund balance may be depleted within the next several years. During the June 1999 performance audit conducted by the Office of the State Auditor, the auditors found that the Trust Fund's administrative costs were unreasonably high given the low amount of funding it manages. We again found problems with high administrative costs during our current procedures. We noted that program grant and contract

expenditures equaled \$372,000, or only about 65 percent of total program expenditures; the remaining \$200,000, or 35 percent, covered administrative costs such as personal services, operating expenses, professional services, and indirect costs. We believe this is an excessive amount of administrative costs for the program. In particular, we found that the Department charged personal services costs of over \$148,000. These costs included about \$136,000 for 2.1 FTE for CCTF and retirement payouts totaling about \$12,000 for Prevention and Intervention Services for Child and Youth Division employees who had not worked for CCTF. These retirement payouts were improperly charged to the program and should be repaid by the Division. The remaining \$136,000 in personal services expenditures equates to about seven grants per FTE, or an annual cost of about \$9,000 in personal services costs for each grant.

After the conclusion of the procedures, the Department reported that 0.6 FTE and \$56,000 in revenues and personal services costs charged to the Trust were misclassified and should not have been included in the total personal services amount mentioned above. If the \$56,000 were excluded from the CCTF's expenditures, administrative costs would represent 28 percent of the total expenditures. This is still a high amount of overhead costs.

High administrative costs redirect dollars away from providing grants to local entities that fund services to meet the statutory intent of the program: to reduce the incidence of child abuse and neglect for Colorado's children. The Department should reevaluate all administrative costs for the CCTF, in particular the current level of FTE assigned to the program, and take steps to reduce administrative expenditures to a more reasonable level so that more funds are available for grants and so that expenditures do not exceed revenue. In addition, only program-related costs should be charged to CCTF.

Recommendation No. 19:

The Department of Public Health and Environment should evaluate the administrative expenditures for the Colorado Children's Trust Fund and reduce them as appropriate to eliminate the deficit spending for the program.

Department of Public Health and Environment Response:

Partially agree. While the Department recognizes that a continuous evaluation of administrative expenditures (personal services, professional services, operating and indirect expenses) is an essential management tool,

it is important to recognize the Colorado Children's Trust Fund (CCTF) has significantly reduced its administrative expenditures since the 1999 performance audit when the CCTF was administered by the Department of Social Work at Colorado State University. For example, the CCTF reduced its non-grant and non-contract costs per dollar awarded from \$.71 to \$.41, which reduced the rate of these expenditures from 42 percent to 28 percent of total expenditures. HB 00-1342, which created the Division of Prevention and Intervention Services for Children and Youth, moved the CCTF to the Department of Public Health and Environment. This bill also moved the federally funded Family Resource Center (FRC) program to the Department with no state funds allocated to this program. Due to the spending limitations of the FRC program, efficiencies were realized by assigning the CCTF staff to the management of the FRC program, with personnel, operating, and indirect costs for the FRC program paid by federal dollars. The FTE amount for the CCTF program was reduced from 2.5 in 1999 to 1.5 in Fiscal Year 2003 (2.5 appropriated) and is currently 1.3 in Fiscal Year 2004. A total of 2.1 FTE were assigned to the management responsibilities of both the CCTF and FRC programs and their \$1,088,846 in total grants and contracts for Fiscal Year 2003. If the total expenditures for both programs (CCTF and FRC) were combined, the non-grant and non-contract expenditures were only 15 percent in Fiscal Year 2003.

Implementation date: March 2004.

Recommendation No. 20:

The Department of Public Health and Environment should reimburse the Colorado Children's Trust Fund for the Prevention and Intervention Services for Children and Youth Division retirement payouts charged to the program.

Department of Public Health and Environment Response:

Disagree. As a result of the elimination of our Long Bill line item for retirement payouts during the 2003 legislative session, the Department was obligated to charge these expenditures to a limited number of funding sources. In addition, federal OMB Circular A-87 does not allow retirement costs to be direct charged to federal grants and approximately 75 percent of the Division's budget comprises federal funds. Given the unpredictability of retirement payouts and the timing of some retirements at year-end when spending authority is limited, the Division had no choice but to use CCTF to charge a small portion of the Department's retirement payout costs.

Implementation date: Not applicable.

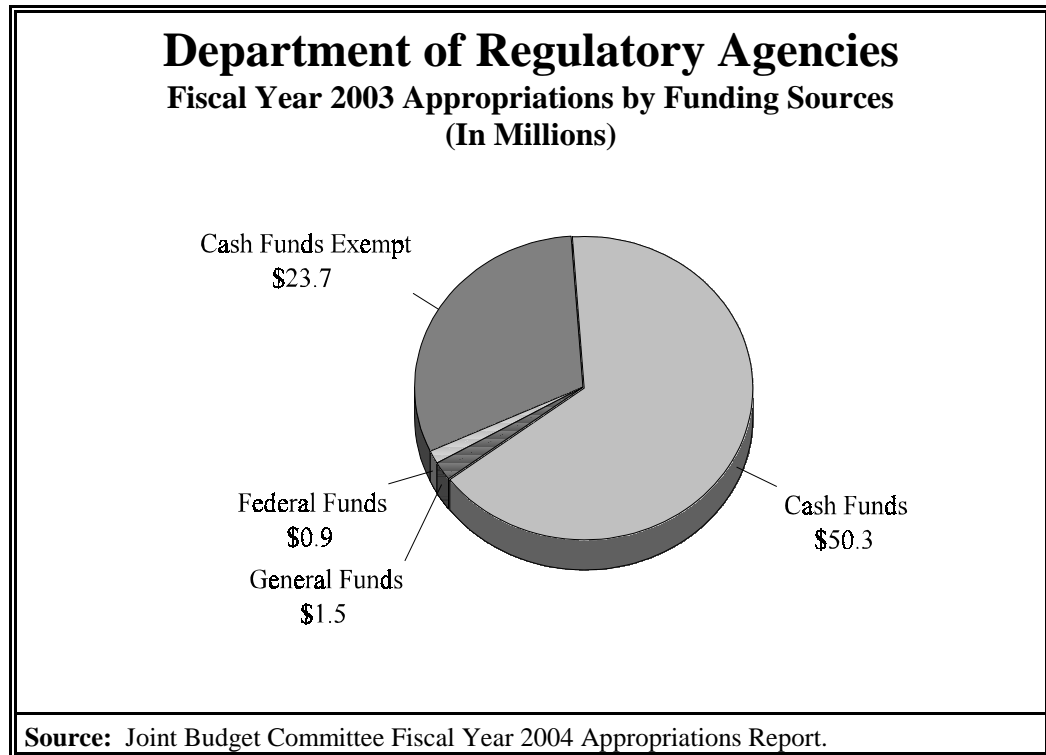
Department of Regulatory Agencies

Introduction

The Department of Regulatory Agencies oversees various professions and industries and includes the following:

- Executive Director's Office
- Division of Banking
- Civil Rights Division
- Office of Consumer Counsel
- Division of Financial Services
- Division of Insurance
- Public Utilities Commission
- Division of Real Estate
- Division of Registrations
- Division of Securities

The Department of Regulatory Agencies was appropriated \$76.4 million and 527 full-time equivalent (FTE) staff for Fiscal Year 2003. Approximately 97 percent of the funding is from cash funds and cash funds exempt sources.



Cash Funds Revenue Recognition

The Department is primarily funded from cash fees, and it is important that it establish and maintain strong management controls over revenue. Each division and commission within the Department is responsible for collecting, depositing, and recording its fee revenue. The Department accounts for the various licenses and fees it administers in various cash funds.

Licenses are renewable at varying intervals, such as every year, every two years, or every three years. Therefore, whenever the Department collects revenue in one year that covers a licensing period that extends beyond that year, according to generally accepted accounting principles (GAAP), it must allocate the revenue among several fiscal years. In other words, revenue not applicable to the initial fiscal year should be recorded as deferred revenue until the appropriate period, but recognition should not extend past the licensing period to which it pertains. To do so would be overcharging licensees in order to pay for costs associated with future licensing periods.

Section 24-34-105, C.R.S., which created the Division of Registrations Cash Fund, requires that each board and commission adjust its fees annually so that the revenue generated from its fees approximates its direct and indirect costs. During our audit we found that the Department made adjustments to revenue and deferred revenue which were not in accordance with GAAP and statutory requirements.

For example, the license period for certified public accountants is two years. The current license period runs from June 1, 2002, through May 31, 2004. We found about \$420,000 in licensing fees that should have been recognized as revenue during the previous licensing period was deferred and not recognized as revenue until the current licensing period. As a result, it appears the Department was allocating revenue from a previous licensing period to cover expenditures from the current licensing period. In addition to the practice's not being in accordance with GAAP and statutory requirements, it likely results in assessing fees too high with respect to related costs for the license period.

We also found that the Department did not recognize revenue in a consistent manner among all of the Department's division and commissions. Of the 33 boards and commissions within the Division of Registrations, 29 are required to allocate and recognize revenue among licensing periods. Of these 29 boards, revenue was recognized in accordance with GAAP and allocated correctly among licensing periods for 12 of the boards. However, for 17 of the boards, revenue was not recorded in a manner consistent with GAAP.

As a result of our audit, the Department submitted adjustments to correct the misstatements and correctly recognize revenue in accordance with GAAP. If the adjustments had not been made, Fiscal Year 2003 revenue would have been understated by about \$420,000. Revenue was understated by about \$2.2 million in Fiscal Year 2002 and overstated by \$360,000 in Fiscal Year 2001. Therefore, the fund balance was increased by about \$1.8 million at June 30, 2003, to correct the Fiscal Year 2002 and 2001 misstatements.

In addition, the Department's cash funds are subject to the provisions of Senate Bill 98-194, which was enacted in order to:

... assure compliance with the limitation on state fiscal year spending and to make fundamental fiscal policy decisions establishing the level of activity of all departments and agencies of state government, including those funded by revenues generated from fees. (Section 24-75-402(1)(e), C.R.S.)

To accomplish this objective, SB 98-194 established a limit on the amount of reserves that may be maintained in cash funds. Generally, the reserve limit is equal to 16.5 percent of the total expenditures in the cash fund during the fiscal year. If the applicable statutory limit is exceeded, agencies are required to reduce fees accordingly. Alternatively, in accordance with Section 24-75-402 (8), C.R.S., an agency may request that the General Assembly grant a waiver of the target reserve requirement by demonstrating a specific purpose for which the excess uncommitted reserves is needed.

Prior to the audit adjustments, the Department reported that all balances in cash funds except for the Nuclear Materials Transport Cash Fund and the Disabled Telephone Users Cash Fund were within the statutory limitation on the Cash Funds Uncommitted Reserves Report, which reports on agencies' compliance with limitations under SB 98-194, for Fiscal Year 2003. However, after the revenue was properly recorded, the Real Estate Cash Fund and the Division of Registrations Cash Fund also had excess uncommitted reserves of about \$1 million and \$762,000, respectively, at June 30, 2003. Additionally, our office questions whether the Division of Registrations Cash Fund should be reported as a single fund for the Cash Funds Uncommitted Reserves Report, or if each individual board and commission should be reported separately (see the Fiscal Year 2003 Cash Funds Uncommitted Reserves Report for further discussion). At the end of the audit, the Department reported that it had completed an analysis of the revenue, deferred revenue, and fund balances for the 17 boards and commissions within the Division of Registrations Cash Fund where problems had been identified. The Department should use the results of this analysis to assess the appropriateness of all fees charged by these agencies and make appropriate adjustments as needed.

Recommendation No. 21:

The Department of Regulatory Agencies should record revenue in accordance with generally accepted accounting principles. If proper revenue recognition results in excess fund balance, the Department should comply with SB 98-194 requirements by either reducing fees or requesting a waiver in accordance with Section 24-75-402 (8), C.R.S.

Department of Regulatory Agencies Response:

Partially agree. The Department of Regulatory Agencies (DORA) recognizes license renewal revenue using an approximately 20 year-old methodology that up until now received no previous audit exception. The adjustments related to fund balance occur in fiscal years where the license period ends and begins for multi-year licenses, and are related to reserves from the various other sources of revenue these particular DORA agencies have in addition to license renewal revenue. Our long-standing methodology and accrual deferral process is for the license renewal fee revenue only, and takes into consideration the other factors that impact fund balance during the course of a fiscal year and the closing of revenue and expense to fund balance.

DORA plans to implement a change to a strict GAAP methodology as of July 1, 2003 for the Division of Registrations since the two-year renewal cycle for

those divisions would end in Fiscal Year 2004 and the deferrals therefore, zero-out, and as of July 1, 2004 for Real Estate and Securities. Thus as of July 1, 2004, all DORA divisions will use GAAP methodology. However, not all divisions may immediately appear in perfect compliance with GAAP nor SB 98-194 due to the transition to a full GAAP methodology during the statewide financial audit for Fiscal Year 2004.

As a practical matter, any time a fund carries a balance into a new licensing period (whether that balance is \$1 or \$400,000), prior renewal revenue is covering expenditures for a current renewal period. From DORA's perspective, the critical issue is making sure to charge licensees as accurate a fee as possible. This has been accomplished for nearly a quarter century using a non-GAAP accounting method.

Implementation date: July 1, 2004.

Auditor's Addendum:

State law requires financial reporting on the basis of generally accepted accounting principles. Annually, management has provided written assurances to the State Controller's Office that the Department maintains compliance with state fiscal rules and procedures and prepares its financial statements and reports in accordance with generally accepted accounting principles as part of its regular operating duties.

The real issue here is that by deferring revenue, the Department, in essence, is charging its licensees more than allowed by law. Section 24-34-105, C.R.S., requires that each board and commission adjust fees annually so that revenue generated from its fees approximates its direct and indirect costs. As noted in the comment, after the Department properly recorded its revenue in accordance with generally accepted accounting principles, the Division of Registrations and the Real Estate Cash Fund had excess uncommitted reserves under SB98-194 of about \$762,000 and \$1 million, respectively.

The Department is not allowed to build a rainy day fund. Excess fund balances as described by SB98-194 have been the subject of audit comments to the Department in the Cash Funds Uncommitted Reserves Report in Fiscal Years 2001 and 2003.

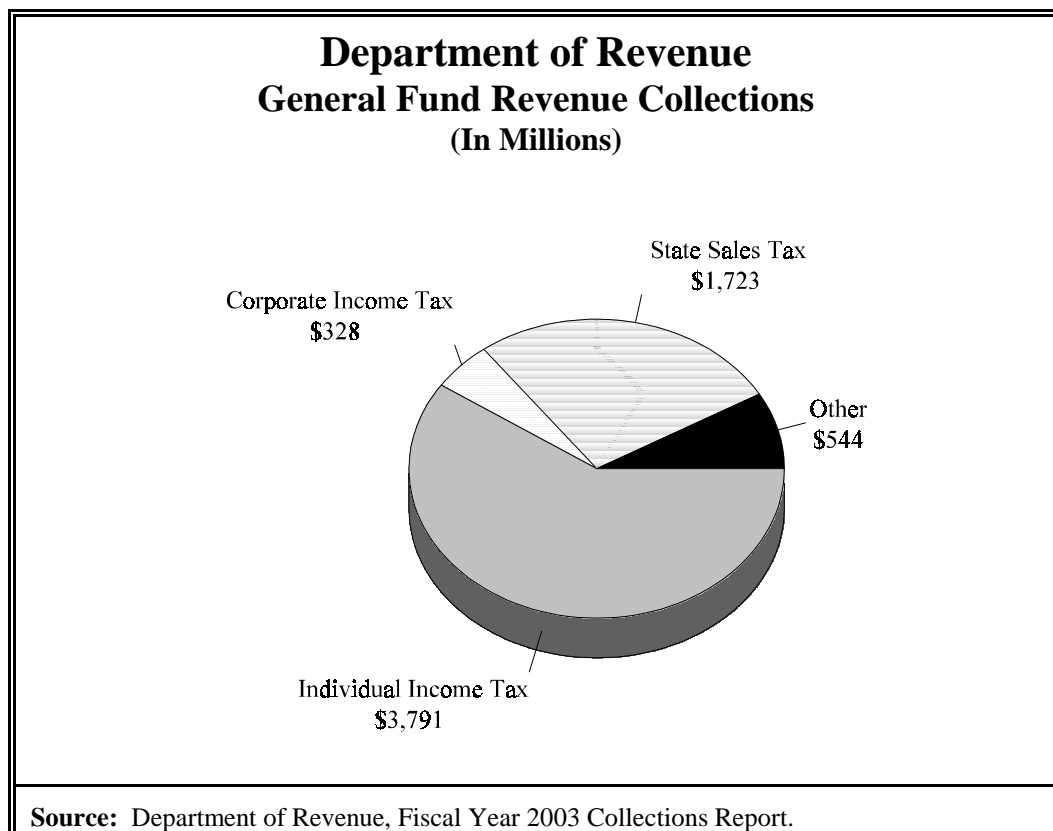
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Department of Revenue

Introduction

The Department of Revenue is responsible for managing the State's tax system. Tax collections totaled about \$8 billion in Fiscal Year 2003. Of this amount, about \$6.4 billion represents collections for the General Fund; the remainder represents collections made on behalf of entities such as local governments and for the Highway Users Tax Fund. In addition, the Department is responsible for performing various other functions as follows:

- Administer the State Lottery, which grossed over \$391 million in ticket sales in Fiscal Year 2003. Of this amount, about \$105 million was available for conservation as well as for wildlife, parks, open space, and outdoor recreation projects.
- Act as a collection agent for city, county, RTD, and special district taxes. The Department received over \$794 million in taxes and fees on behalf of other entities.
- Collect taxes and fees for the Highway Users Tax Fund (HUTF), which is primarily for the benefit of highway maintenance projects in the State. In Fiscal Year 2003, amounts collected for the HUTF totaled approximately \$766 million.
- Regulate the limited stakes gaming activities in Cripple Creek, Black Hawk, and Central City. Adjusted gross proceeds totaled about \$707 million during Fiscal Year 2003, on which the Limited Gaming Division collected about \$97.5 million in gaming taxes.
- Enforce tax, alcoholic beverage, motor vehicle, and emissions inspection laws.
- Operate the State's 19 Ports of Entry.



In Fiscal Year 2003 the Department was appropriated of over \$529 million and 1,518 full-time equivalent staff (FTE).

Tax Conferee Estimates

The Tax Conferee Section resolves tax cases being disputed by taxpayers and represents the Department in tax litigation. The Section is responsible for handling a variety of tax disputes, such as corporate and individual income, use, and sales.

In Fiscal Year 2003 the Tax Conferee Section had approximately \$77 million in taxes receivable and approximately \$28 million in refund claims payable, compared with \$105 million and \$19 million, respectively, in Fiscal Year 2002. The Conferee uses a two-tiered method for estimating its tax cases at fiscal year-end. Cases over \$2 million are reviewed individually. For cases under \$2 million, historical collection and payment rates are utilized. In Fiscal Year 2003, cases under \$2 million accounted for about \$28 million, or about 37 percent of the Conferee taxes receivable, compared with Fiscal Year 2002, in which cases under \$2 million accounted for about \$42 million, or about 40 percent of the Conferee taxes

receivable. Historical rates for the cases under \$2 million are stored in an internal case management database.

During our audit we found that although the Conferee used historical information for its estimates for cases under \$2 million, the historical information had not been updated with the actual data from the past two fiscal years. Estimates were based on historical amounts that were collected and paid during Fiscal Years 1997 through 2000. The two most recent fiscal years' data were not incorporated into the estimates because staff were unable to access this information from the case management database. As a result, we could not determine if the more recent data would significantly impact the estimate. The individual who maintained the database has left the Department, and although procedures had been documented for accessing the data, staff have been unsuccessful in using these to obtain historical information.

If historical rates are utilized as part of an estimating process, the historical information should be updated with recent years' information. Otherwise, an alternative method for estimating taxes receivable and refund claims payable for cases under \$2 million should be implemented.

Recommendation No. 22:

The Tax Conferee Section should incorporate the most recent years' historical collection and refund claims payments information in its fiscal year-end estimating process. If recent historical rates cannot be accessed, an alternative estimating methodology should be implemented for cases under \$2 million.

Department of Revenue Response:

Agree. A project request will be submitted to the Department's Information Technology Division to write the necessary reports to access the recent historical rates to more accurately estimate collections and payables. The Department expects to have the reports completed by fiscal year-end for use in the Fiscal Year 2004 estimates.

Implementation date: June 30, 2004.

Recommendation No. 23:

The Department of Revenue should cross train staff and have adequate written procedures for data retrieval in place to ensure that access to information is not compromised by employee turnover.

Department of Revenue Response:

Agree. By having the Department's Information Technology Division (ITD) write the reports to access the historical data for the year-end inventory estimates, adequate staff will be available, procedures will be documented to meet future maintenance needs, and the process will be significantly less compromised by employee turnover. The standard procedures for the System Development Life cycle employed by ITD require this cross training and back-up staffing.

Implementation date: June 30, 2004.

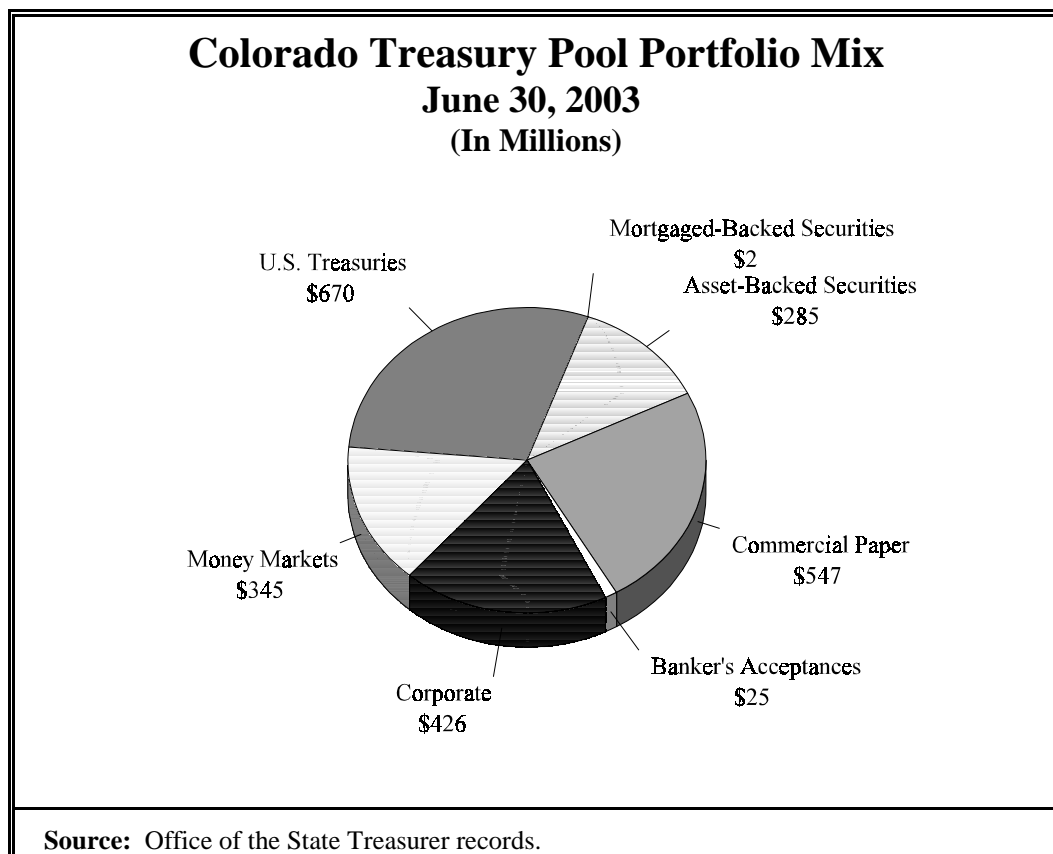
Office of the State Treasurer

Introduction

The Office of the State Treasurer (Treasury) is established by the State Constitution. The Treasurer is an elected official who serves a four-year term. The Office manages the State's investments, and implements and monitors the State's cash management procedures. Other duties and responsibilities include:

- Receiving, managing, and disbursing the State's cash.
- Safekeeping the State's securities and certificates of deposit.
- Managing the State's Unclaimed Property Program, the School District Loan Program, and the Elderly Property-Tax Deferral Program.

The State's pooled investments are made up of a variety of securities as shown in the following chart:



The following was prepared by the public accounting firm of Grant Thornton, LLP, which performed the Fiscal Year 2003 audit work at the Office of the State Treasurer.

Highway Users Tax Fund

The Department of Revenue is responsible for collecting Highway Users Taxes from fuel taxes and motor vehicle registrations, and submitting the taxes to Treasury. According to Section 43-4-205, C.R.S., Treasury is responsible for allocating and distributing these monies to the appropriate state agencies and local governments based upon specific percentages prescribed in statute.

During our testwork on Highway Users Tax Fund distributions, we noted two exceptions, both of which resulted in incorrect allocations to local governments. The first exception was a result of an incorrect allocation factor entered by Treasury for the municipality level, which affected all municipalities in the allocation. Ultimately, one city received approximately \$215,000 less than it should have, while all other municipalities received, in aggregate, \$215,000 more. The second exception was an allocation problem by Treasury for the county level and impacted two counties. One county received \$970,000 more than it should have, and the other received \$970,000 less due to incorrect entry of motor vehicle registration data.

Both exceptions resulted from data entry errors at Treasury. We found that one employee was responsible for calculating the distributions and that the employee's work was not reviewed by another employee. As a result, the first error went undetected from July 2002 until April 2003. Treasury corrected the error before the close of the fiscal year. The second error, which also occurred in July 2002, went undetected until August 2003, and Treasury plans to adjust Fiscal Year 2004 allocations to correct the error.

Recommendation No. 24:

The Office of the State Treasurer should adjust the Fiscal Year 2004 allocations to counties to correct the Fiscal Year 2003 error related to vehicle registration data. In addition, Treasury should implement review procedures over Highway Users Tax Funds distributions to ensure that the amounts are calculated correctly before issuing the payments to State agencies and local governments.

Office of the State Treasurer Response:

Agree. The accounting section of Treasury has already implemented this recommendation. Fiscal Year 2004 county payments have been adjusted for the Fiscal Year 2003 error.

Staff has implemented a system of checks and review to ensure that any data entry errors will be corrected at the beginning of the fiscal year before any distributions to cities or counties are made. This review includes manual verification of data entry by the supervisor of the accountant responsible for the distributions.

Additionally, spreadsheets have been created that will provide reasonableness checks of mileage, factors, and registrations comparing these numbers with the previous year to ensure that the information provided to Treasury by other agencies is correct.

Implementation date: September 2004.

Compliance With Colorado Funds Management Act

The Colorado Funds Management Act (the Act) under Section 24-75-901, C.R.S., was enacted to allow the State to finance temporary cash flow deficits caused by fluctuations in revenue and expenditures. Under the Act, the State Treasurer is authorized to sell Tax and Revenue Anticipation Notes (TRANS). TRANS are short-term notes payable from the future anticipated pledged revenue.

The Office of the State Auditor reviews information relating to tax and revenue anticipation notes and reports this information to the General Assembly as directed by Section 24-75-914, C.R.S. The following discussion provides information about the Treasurer's July 3, 2003, issuance of \$300 million in General Fund Tax and Revenue Anticipation Notes (hereafter referred to as the General Fund Notes) and the July 11, 2003, issuance of \$195 million in Education Loan Program Tax and Revenue Anticipation Notes (hereafter referred to as the Education Loan Program Notes).

Terms and Price

The General Fund Notes have a maturity date of June 25, 2004, and the Education Loan Program Notes have a maturity date of August 9, 2004. Neither is subject to redemption prior to maturity. The maturity of the General Fund Notes comply with the Act, which requires the maturity date to be at least three days prior to the end of the fiscal year. The maturity date of the Education Loan Program Notes complies with House Bill 03-1274, which allows the TRANS to mature any date on or before August 31 of the fiscal year immediately following the fiscal year in which the Notes were issued. In addition, according to HB 03-1274, on or before the final day of the fiscal year in which the Notes are issued, there shall be deposited, in one or more special segregated and restricted accounts, and pledged irrevocably to the payment of the Notes an amount sufficient to pay the principal and interest related to the Notes on their stated maturity date.

State of Colorado		
Details of the General Fund and Education Loan Program Note Issues		
Issue Amount:	General Fund	\$300,000,000
	Education Loan Program	\$195,000,000
Denomination (both series)		\$5,000
Premium on Sale:	General Fund	\$3,127,824
	Education Loan Program	\$1,452,500
Face Interest Rate:	General Fund	1.75-2.00%
	Education Loan Program	1.75%
Average Interest Cost to the State:	General Fund	.872%
	Education Loan Program	1.122%
Source: Office of the State Treasurer records.		
Note: The average interest cost to the State was calculated by Treasury based upon the net interest cost on each issue.		

Notes in each series are issued at different face interest rates. These are the rates at which interest will be paid on the Notes. The average interest cost to the State differs from the face amount because the Notes are sold at a premium, which reduces the interest expense incurred.

Security and Source of Payment

In accordance with the Act, principal and interest on the General Fund Notes are payable solely from any cash income or other cash receipts recorded in the General Fund for Fiscal Year 2004. General Fund cash receipts include those that are subject to appropriation in Fiscal Year 2004 and any pledged revenue, including the following:

- Revenue not yet recorded in the General Fund at the date the Notes were issued.
- Any unexpended Note proceeds.
- Proceeds of internal borrowing from other state funds recorded in the General Fund.

The State Treasurer records monies reserved to pay the principal and interest of the Notes in the 2003 Note Payment Account (Account) on the State's accounting system. The holders of the Notes are secured by an exclusive first lien on assets in the Account. The State Treasurer holds, in custody, the assets in the 2003 Note Account.

If the balance in the Account on June 15, 2004, is less than the principal and interest of the General Fund Notes due at maturity, the Treasurer must deposit into the Account all general fund revenue then available and borrow from other state funds until the balance meets the required level.

According to HB 03-1274, interest on the Education Loan Program Notes is payable from the General Fund. Principal on the Notes is payable solely from the receipt of property taxes received by the participating school districts on and after March 1, 2004, that are required to be deposited to the general fund of each district.

If, on June 25, the balance in the Education Loan Program Notes Repayment account is less than the principal of the Education Loan Program Notes at maturity, the Treasurer shall deposit from any funds on hand that are eligible for investment an amount sufficient to fully fund the Account. The Treasurer intends to use amounts from the State Education Fund, if necessary, to meet this obligation.

The amount due at maturity for the General Fund Notes is \$305,744,445, consisting of the Note principal of \$300,000,000 and interest of \$5,744,445. The amount due at maturity for the Education Loan Program Notes is \$198,640,000, consisting of the Note principal of \$195,000,000 and interest of \$3,640,000. To ensure the payment

of the General Fund and Education Loan Program Notes, the Treasurer has agreed to deposit pledged revenue into the Account so that the balance on June 15, 2003, and June 30, 2004, respectively, will be no less than the amount to be repaid. The Note agreement also provides remedies for holders of the Notes in the event of default.

Legal Opinion

Sherman and Howard, LLC and Kutak Rock LLP, bond counsels, have stated that, in their opinion:

The State has the power to issue the Notes and carry out the provisions of the Note agreements.

The General Fund and Education Loan Program Notes are legal, binding, secured obligations of the State.

Interest on the Notes is exempt from taxation by the United States government and by the State of Colorado.

Investments

Both the Colorado Funds Management Act and the General Fund and Education Loan Program Note agreements allow the Treasurer to invest the funds in the Account in eligible investments until they are needed for Note repayment. Interest amounts earned on the investments are credited back to the Accounts. The State Treasurer is authorized to invest the funds in a variety of long-term and short-term securities according to Article 36 of Title 24, C.R.S. Further, Section 24-75-910, C.R.S., of the Funds Management Act states that the Treasurer may:

Invest the proceeds of the Notes in any securities that are legal investments for the fund from which the Notes are payable.

Deposit the proceeds in any eligible public depository.

Purpose of the Issue and Use of Proceeds

The General Fund Notes are being issued to fund the State's anticipated general fund cash flow shortfalls during the fiscal year ending June 30, 2004. The proceeds of the sale of the General Fund Notes were deposited in the State's General Fund. Note proceeds will be used to alleviate temporary cash flow shortfalls and to finance the

State's daily operations in anticipation of taxes and other revenue to be received later in Fiscal Year 2004.

The Education Loan Program Notes are issued to fund a portion of the anticipated cash flow shortfalls of the school districts during the State's fiscal year ending June 30, 2004. The net proceeds of the sale of the Notes will be used to make interest-free loans to the school districts in anticipation of the receipt of property tax revenue by the individual districts on and after March 1, 2004, to and including June 25, 2004.

Additional Information

The Notes were issued through a competitive sale. A competitive sale involves a bid process in which notes are sold to bidders offering the lowest interest rate.

The Notes issuance is subject to the Internal Revenue Service's (IRS) arbitrage requirements. In general, arbitrage is defined as the difference between the interest earned by investing the Note proceeds and the interest paid on the borrowing. In addition, if the State meets the IRS safe harbor rules, the State is allowed to earn and keep this arbitrage amount. The Office of the State Treasurer is responsible for monitoring compliance with the arbitrage requirements to ensure that the State will not be liable for an arbitrage rebate.

State Expenses

The State incurred expenses as a result of the issuance and redemption of the TRANS. These expenses were approximately \$381,360 for the General Fund and Education Loan Program Notes. The expenses include:

- Bond legal counsel fees and reimbursement of related expenses incurred by the bond counsel.
- Disclosure counsel fees and expenses.
- Fees paid to rating agencies for services.
- Costs of printing and distributing preliminary and final offering statements and the actual Notes.
- Travel costs of state employees associated with Note issuance and selection of a financial advisor.

- Redemption costs, consisting of fees and costs paid to agents to destroy the redeemed securities.

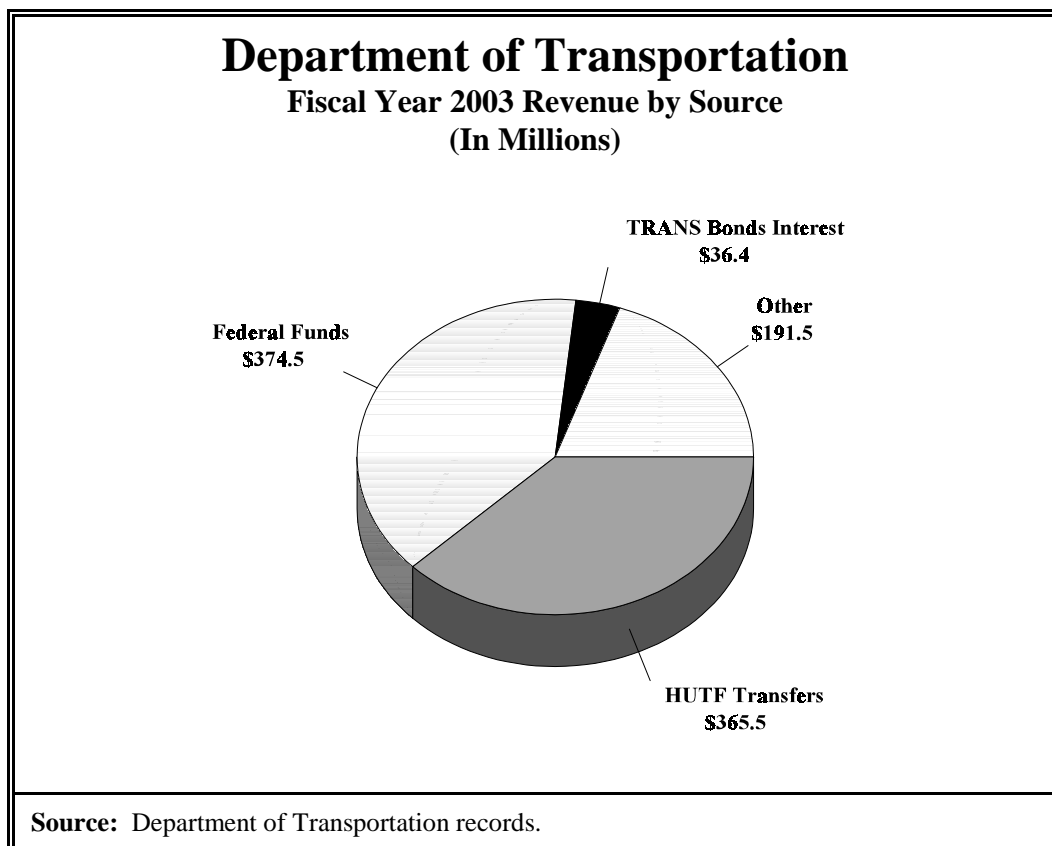
No recommendation is made in this area.

Department of Transportation

Introduction

The Colorado Department of Transportation is responsible for programs that impact all modes of transportation. The State Transportation Commission governs its operations.

In Fiscal Year 2003 about 86 percent of the Department's expenditures were related to construction. Funding for construction and other expenditures come from the Federal Highway Administration (FHWA), the Department's portion of the State Highway Users Tax Fund (i.e., the State Highway Fund), local entities, and aviation-related taxes. The Department also receives monies from other federal agencies that it passes through to local governments and other entities for highway safety and transportation improvement programs. In addition, the Department earned interest of \$36.4 million on Transportation Revenue Anticipation Notes (TRANS) proceeds with trustee during Fiscal Year 2003. The Department was appropriated about 3,229 full-time equivalents for Fiscal Year 2003. The Department's Fiscal Year 2003 funding totaled \$967.9 million as shown in the following chart:



The following comments were prepared by the public accounting firm of Grant Thornton LLP, which performed Fiscal Year 2003 audit work at the Department of Transportation.

Security Over Credit Card Reconciliation System

Starting in Fiscal Year 1999, the Department allowed employees to use Department-issued credit cards for purchases under \$5,000. These purchases are primarily made by the Department's maintenance staff and include materials and supplies, as well as truck repair parts. In order to assist in sorting and reconciling the credit card purchases, the Department developed a database program. However, unauthorized personnel had the ability to access credit card information on the database and the database was not protected from unapproved changes, such as alterations of the amounts reported. The database program is used to post entries to the State's accounting system, but the program's functionality was not tested to make sure that the program was operating as intended and that the program was secure.

In 1999 we recommended that the Department transfer custody of the reconciliation database program to its information technology group to determine whether the program functions properly. If the information technology group was satisfied with the design of the reconciliation program, the program should be maintained in accordance with the Department's change management procedures in order to protect the data against unauthorized access and change. The Department agreed with the recommendation and during Fiscal Year 2000 the programming was begun. The project was divided into three phases due to budgetary constraints. Because of various delays, the implementation date was extended several times. During Fiscal Year 2002, Phase I was completed and Phase II was scheduled for completion by June 30, 2003. The Department abandoned the programming project in Fiscal Year 2003 due to difficulty in implementation and lack of internal resources. However, the Department still uses the database system.

The Department used existing information technology personnel and equipment to develop the project, so no additional appropriations were needed to finance program development. However, the Department reports it did not track resources used on the project and was unable to provide us with information on the amount expended on the project.

The Department made \$10.8 million of credit card purchases during Fiscal Year 2003. Because of the magnitude of the credit card purchases, it is important for the

Department to have a secure and accurate system in place for monitoring purchases and recording the purchases in the general ledger.

Recommendation No. 25:

The Department of Transportation should implement a secure program to track and reconcile its credit card purchases.

Department of Transportation Response:

Agree. The Department is acquiring a commercial software solution to assist in the reconciliation and tracking of credit card expenditures. This software is currently being used by other departments within the State of Colorado.

Implementation date: September 2004.

Disaster Recovery Plan - Data Center

The Department has an information technology disaster recovery plan that covers all project and financial systems. This plan provides for such items as weekly and daily computer file backups and for off-site storage of those backups. However, we found that it does not provide for a remote data center for use in the event of a disaster. A few of the systems that could be affected by a disaster include the bridge and pavement management systems, the Web site, the human resources system, the facilities and building systems, and the data warehouse.

During Fiscal Year 2003 the Department engaged a third-party consultant to complete a business recovery planning study which addressed the need for off-site data processing capabilities in the event of a disaster. Now that the study is complete, the Department should move forward in securing off-site data processing capabilities for use in the event of a disaster.

Recommendation No. 26:

The Department of Transportation should secure off-site data processing capabilities for use in the event of a disaster that renders current data processing functions partially or fully inoperable.

Department of Transportation Response:

Partially agree. The Department agrees that off-site data storage is a high priority to protect investments made to create and acquire information used in project and financial systems. As such, all contents in the Department's Data Center will be backed up to an off-site location on a daily basis beginning in September 2004. Financial data will also be available through the data center that the Division of Information Technologies maintains for COFRS. With this arrangement in place, the Department will be able to rapidly deploy servers and data processing capabilities in the event of a disaster affecting the headquarters complex if it is necessary. Also, in the same time frame the State of Colorado Portal will begin to be implemented. It is the Department's intent to incorporate that system in our strategy as a backup for internal data processing and the access point to our major project and financial systems.

Implementation date: September 2004.
